

RICHARD PIERCE

## APPEARANCES CONTINUED:

GARI RYGH

ANGEL CARTEGENA

CYNTHIA MARLETTE

JIGNASA GADANI

KEVIN KELLY

WALT COLEMAN

CELIA DAVID

DAN DOYLE

MARIA GULLINI

JOHN McMAHON

ARNOLD QUINT

DON STONE

## PROCEEDINGS

MR. BARDEE: Good morning. My name is Michael Bardee. I'm with the Office of General Counsel. Our topic for today's conference is liability limitations. In Order 888, going back about six years now, the Commission adopted certain provisions dealing with force majeure and indemnification for the open access transmission tariff. But, the Commission decided not to include in the open access tariff a liability limitation.

Since that time, the Commission, and even before that time, the Commission has, in some other settings, allowed liability limitations, either in bilateral or agreements or in tariffs. But, until now, the Commission has not proposed to include those in the open access tariff. But, in the SMD NOPER, the Commission indicated its willingness to reconsider that and examine whether liability limitations were appropriate for inclusion in the SMD tariff. And that's our topic today.

We've arranged for speakers by two panels. And the first panel is generally focused on whether we should allow liability limitations; and the second panel is more focused on if we do, how should that liability limitation be structured; what are the details of that liability limitation.

Having said that, I don't mean to limit any of

the speakers to specific areas. If they have issues that they think are important and would like to comment on, I would encourage them to do so. And with me are several members of FERC staff, who will be asking questions later.

In terms of the general framework, we'll proceed in the usual fashion of allowing each of the speakers to make an opening statement. I would ask that you limit it to about five minutes, if possible, and that will allow enough time for questioning from our side of the table and interaction among the speakers, and possibly even questions from the audience, if time permits.

At this point, it appears that one of our speakers is still missing. But, if he arrives later, we can let him make his statement, at that time. And having said that, I'll turn it over to Commission Bob Garvin, from the Wisconsin Commission.

COMMISSIONER GARVIN: Good morning. I'm Commissioner Bob Garvin from the State of Wisconsin, and I wanted to thank you for giving me the opportunity to provide a Midwest regulator's perspective on some of the specific issues relating to limitation on liability that are discussed in your standard market design NOPER. I have a few brief comments to make with respect to this issue.

First, just as a general observation, the state I represent has a very parochial interest in making sure the

FERC fulfills its stated objectives of providing a more robust electricity marketplace. My first point is that Wisconsin is home to a standalone transmission company, the American Transmission Company. That does not provide any retail service and, therefore, has no retail tariff for service it provides to the load serving entities in our state, let alone any tariffs dealing with its limitations on liability. By operation of state law -- and other speakers, Mr. Dole, maybe this afternoon, will deal with that -- by operation of state law, ATC has no protection under any state retail tariff.

Point number two is that Wisconsin is also home to one of the most constrained interfaces in the United States. That was referenced in the DOE report, issued May of 2002. And we want to make sure that SMD just doesn't manage congestion, but that it alleviates it. And I don't personally believe, nor do my colleagues on the Commission, believe that this will happen without strong liability provisions.

ATC has a very ambitious plan to upgrade the transmission system over the next decade in our state and I'm very skeptical that standalone companies like ATC will be able to even attract capital, if they're exposed to potential unlimited liability attributed to outages.

And thirdly, probably the most important reason

why the FERC needs to craft strong liability limitations is that it's going to reduce cost to customers and achieve the substantive policy goals of this standard market design. I know Dr. Pierce follows me. I would just simply say, I agree wholeheartedly with his analysis; in particular, the reference to the fact that in the absence of having strong liability provisions, customers are ultimately going to pay much higher wholesale rates for service, because of the insurance premiums, increased exposure to litigation, and just the overall risk assessment. So, it's a pretty straightforward risk assessment, in my opinion.

And I guess, again, in the commonsense department, I feel strongly that as a matter of policy, we need to have some type of uniformity, to avoid a patchwork of different liability standards in the MISO footprint. That's Wisconsin's principle concern, because we want to get that right. FERC and the stakeholders there have a tough enough time dealing with planning and siting issues within a 17-state footprints, when you have 17 states, each with their own different siting process. And I think it would be incredibly difficult to build up that type of robust system, without having strong liability provisions.

And with that, I'll turn it over to the next speaker.

MR. O'NEILL: Commissioner, just a clarifying

question, did you say strong liability conditions?

COMMISSIONER GARVIN: Limitation of liability.

MR. O'NEILL: Oh, okay.

COMMISSIONER GARVIN: Thank you.

MR. O'NEILL: Thank you.

COMMISSIONER GARVIN: I was reading my handwritten notes.

MR. BROWN: Good morning. I'm Bill Brown from McNary Consulting. We're an independent insurance risk management consulting firm in Charlotte. We specialize in the utility practice and work with roughly 50 utilities in various aspects of the industry around the country. We, also, have, as a client, ATC, and I was asked to be on this panel on their behalf, speaking to the issues of values of liability limitations.

I guess that I don't have to go too far in explaining the difficulties in the liability insurance marketplace. It's certainly been in the news; not just for utilities, but the liability insurance industry, in general, and much of this, of course, is exacerbated by the 9/11 events.

But even prior to that, the liability insurance industry was having some very difficult times. There's been a very extremely competitive soft marketplace for almost an unprecedented six to seven years. The claims started

rolling in actually in early 2000 and then 9/11 just was kind of the coup de gras.

Following that, we've, of course, had other problems: the Enrons, the World Coms. And to put it bluntly, it's a really messy limited marketplace out there for liability insurance, particularly for utilities, at this time.

What we do, we go in and we help our clients by analyzing their exposures to lawsuits through their operational aspects, their contractual exposures. We evaluate the risk mitigation factors, loss control, their ability to retain risk. We try to do frequency and severity forecast for what losses will occur. And then, we relate that to the breadth of the coverage that they can buy, either insurance coverage they have or potentially can buy, and addressing such things as mandatory exclusions, which there are quite a few new ones that the industry has mandated; i.e., the issue over terrorism, what have you.

In doing the work for ATC, we acknowledge that this is a very difficult client to assess their risk potential, because of unlimited liability that they face. They have a large regional exposure, as I guess all of the RTOs, TOs. The lack of a liability limitations certainly does make it extremely difficult to quantify and model the risk. And then there were these previous state tariff

protections, which I guess they no longer have the benefit of. So, that puts them in somewhat of a precarious position, as far as knowing what they need in the way of protection. Coupled with that is the very limited ability to go out and buy that protection.

There are probably only three real viable options for liability insurance for utilities and one of those options is an industry mutual, that writes about 85 percent of all the utility business in the country. So, it's a tough market.

I guess as a result of these issues, it is very difficult to determine an appropriate level of insurance coverage that a company like ATC would need. I can't stress enough that in the very tight and limited market that is there, the underwriters deal in uncertainty all the time. That's the nature of insurance. When they have an issue with a new entity like the new RTOs exposures, when they cannot quantify the potential loss magnitude, they're definitely going to err on the side of charging too much, until it can be proven that it's too much. And we think we've seen this in some of the pricing that's already been exhibited.

We're hopeful that the insurance marketplace will stabilize somewhat, but it certainly is in a very tumultuous time right now. We've seen pricing increases of 50 percent,

100 percent, multiples of 100 percent, for utilities within the past year-and-a-half. The position they take is if we don't do this, we may not be here to provide this insurance protection in the future. Obviously, we all hope the industry will remain strong, but there is no guarantee. And with unlimited risk and potential claims, again, the industry was tested with 9/11. It has certainly been tested with the Enrons and all the other factors there. So, an industry surplus has been severely curtailed. So, we presume there will be something out there, but whether it's an affordable coverage is really a question mark. And at some point, it becomes non-economic to buy insurance, when you're trading dollars with the insurance marketplace. And then it makes more sense to self-insure, which, again, comes right off the bottom line.

So, we think that the benefits of a liability limitation would be substantial, with regard to affecting a more stable marketplace, an availability of market, really, for companies that are RTOs. And we would encourage the Commission to give strong consideration in including this in the SMD. Thank you.

MR. BARDEE: Thank you, Mr. Brown. Mr. Corneli?

MR. CORNELI: Thank you. Steve Corneli from NRG.

I'm very pleased to be here and, particularly, appreciate the opportunity to present competitive supplier, our

supplier perspective, which is, I think, unique in the industry. We, certainly, have some of the characteristics and concerns that the RTO and transmission provider groups have, because, like them, we can actually cause or be perceived to cause imperfections and interruptions in transmission service. So, we have an interest in the protection side of liability.

But, like end-use customers, we can be severely harmed by the lack of deliverability of our product. So, we, also, have an interest on the side of being able to go after the folks, who cause those damages, which puts us, I think, in a unique position to comment on and offer some hopefully useful advice or perspective to the Commission, in grappling with this issue.

To make it fairly brief, we have three basic concerns. And the first one is that while most competitive power suppliers support some degree of liability limitation, because we recognize it can be helpful in establishing large and competitive RTO-based markets, we have concerns that the balance or the right focus and targeting of that protection be struck in the final rule.

And as I see it, it's essentially a balancing between the types of concerns that Mr. Brown has just articulated, uncertainty about the cost of insurance, uncertainty about the cost of insuring against the risk of

losses that are caused by RTO's negligence, versus the balance of the ability to get compensation for damages by those, who are damaged, and the incentive characteristics of liability. In other words, we would like to see the Commission strike a balance that would preserve healthy incentives, some meaningful opportunities for compensation, at least in the case of egregious negligence, and the desires and needs of the RTOs, to carry out their businesses in a commercially viable manner. So, that's the first issue, would be balance and balance based on the real needs and the real problems that liability presents.

The second issue that's important to us relates to the fact that, as I mentioned before, we can actually cause, either directly or indirectly, imperfections or interruptions in transmission service. For example, if we do not follow proper or if we follow properly, but follow improper directives properly from the RTOs, we can be part of the change of causal factors that leads to transmission outages or other service imperfections. Our concern here is that whatever the ultimate levels of liability limitations you decide upon for the transmission owners, they should also be extended to generators and, indeed, to any other entities, who can likewise contribute to or cause transmission service imperfections. Not to do this would essentially create one party of potential deep pocket

targets for all the liability associated with all the transmission imperfections and it would be like lightning rods to be struck by plaintiffs seeking damages that they could no longer seek from transmission owners, RTOs, or ITPs.

The third concern we have is that much of the argument, especially the policy level argument that has been presented for why limiting liability will reduce costs and result in a more efficient marketplace, really seem to us to be derived from unique characteristics of end-use customers, rather than generators and power suppliers.

In fact, I would recommend strongly that if you haven't perused the paper and affidavit of Sally Hunt, that was attached to MISO and ATC's original request last spring for limitation of liability, that you do so, because Ms. Hunt actually makes the same point, that the potential for such inefficient behaviors, as cross subsidies of low-risk customers by high-risk customers, of moral hazard or improper self-insurance by high-risk customers, of adverse selection, of driving the cost of transmission service to the cost of the most risky customers, all of those apply, according to Ms. Hunt, more properly to end-use customers than to generators. And we certainly agree with that.

Now, Ms. Hunt recommends that -- concludes that generators have a much better case for actually having legal rights to compensation for damage from negligent acts by

RTOs or ISOs. She recommends that that compensation be carried out by allocating congestion revenue rights to generators, so that they can recover some of the price spread that might be created by delivery interruptions. It's a novel idea.

Our view on that is that we agree that we are different from load and that in the liability limitations that you do adopt, you should explore and consider preserving limited rights for generators, to get compensation for damages that are due to negligent acts on the part of transmission providers. And one example that was suggested by EPSA, in its comments in the MISO docket, was that the liability limitations allow for and require transmission providers to the liquidated damages associated with non-delivery under many power contracts. This could be capped at a reasonable level and could be triggered only by the appropriate negligence standard. But, it would preserve some of the compensation that we really rely on, basically, to do our business.

So, those three factors, balancing and targeting the limitations where they're really needed, extending them to generators, and preserving some commercially meaningful means for us to be compensated for serious commercial harm due to lack of delivery are what we request you consider in the rule. And, of course, we, also, agree with Ms. Hunt

that CRRs will be a very useful tool for hedging all sorts of delivery-related risks in the future market and we would ask that the SMD rule make those CRRs broadly and rapidly available to generators through a complete auction. Thank you.

MR. BARDEE: Thank you, Mr. Corneli. Professor Pierce?

PROFESSOR PIERCE: Thank you. My name is Richard Pierce, -- Lyle P. Albertson research professor of law at George Washington University. I've taught law for 25 years and courses I teach include basically all the subjects that are relevant -- antitrust, administrative law, regulatory industry. I've written a dozen books and over 80 articles about government regulation, various forms of government intervention, including --

MR. BARDEE: Professor Pierce, could you turn the mic on?

PROFESSOR PIERCE: -- including regulation and tort law on the performance of markets. I've been actively involved in the process of restructuring the natural gas and electricity markets in North America and Europe for over two decades. I think a copy of my resume is already in the record of this proceeding. If anybody needs another copy, I've got some with me today.

I want to begin by thanking the Commission for

allowing me to speak today and, also, for having the wisdom and the courage to propose the standard market design tariff. I'm extremely supportive of the Commission's efforts, in this proceeding. I strongly support the basic elements of the standard market design tariff.

The only purpose of my statement today is to attempt to persuade the Commission to include provisions in the tariff that limit the potential tort liability of owners and operators of transmission facilities that are subject to the tariff.

Earlier this year, I submitted a report to the Edison Electric Institute, in which I concluded that federal limits on the potential tort liability of owners and operators of transmission lines are an essential element of a socially beneficial program, to restructure the U.S. electricity market. Versions of that report have already been submitted previously in this proceeding, as well as in the MISO proceeding, and another version was published in the Energy Law Journal a couple of months ago. I have more copies of that around today, too, if anybody needs an extra copy.

As I detail in the report, states have limited the potential tort liability of owners and operators of transmission and distribution facilities for good reasons for almost a century. Those limits have been authorized,

approved, or upheld in score of well-reasoned decisions of state public utility commissions and state courts. It's not at all clear, however, that any of those state approved tariff provisions will apply to transmission facilities that are subject to the standard market design tariff.

You've already heard from Commission Garvin today, that under Wisconsin law, the state-approved tariffs will not have any application to ATC. I think as other state commissions become aware of what's happening and start to reflect on the implications of the changes in the structure of the industry and the jurisdictional status of transmission that this Commission is in the process of implementing, that they will also conclude that their retail tariffs have no bearing whatsoever on the liability of transmission companies that, to a considerable and growing extent, are subject to exclusive FERC regulation.

The liability limitation provisions that the states previously authorized were authorized in the context of states that believed, at least, that they had the plenary power to regulate the rate, terms, and conditions of transmission within their state. As they realized that the changes that this Commission is in the process of making are shifting that regulatory jurisdiction to the Federal Energy Regulatory Commission, they will begin to do as Wisconsin has told you they already concluded, that they will conclude

that their limitation provisions have no application at all to the transmission services that are regulated by this Commission.

Members of EEI and others of my clients would prefer that I whisper all of this, so that it not make its way to the ears of the many tort lawyers that are just waiting for the next outages somewhere in the country to bring their suits. Unfortunately, I haven't figured out how to speak in a clear voice in some fora, but to whisper in others. If some of the commissions continue to take the position, and some of them do today, that these provisions continue to apply to transmission that is provided subject to the regulatory power of this Commission, rather than a state commission, I have very little doubt that the state courts will soon correct their misimpression and will conclude, in the context of either tort cases or judicial review cases, that the state provisions do not apply and provide no protection whatsoever.

Well, since the need for the protection is at least as great in the restructured market context that this Commission is in the process of creating, as it was over the last 100 years, and since the state liability limitation provisions are, I am quite confident, inadequate forms of protection for the utilities, I urge this Commission strongly to include, in the standard market design tariff,

provisions that limit the potential tort liability of owners and operators of transmission facilities that are subject to this Commission's jurisdiction.

In the course of the report that is already in the record in this proceeding, I have addressed each of the questions that the Commission posed to panel one; but, I would be glad to answer any questions you may have about my statement and about the report. Thank you.

MR. BARDEE: Thank you, Professor Pierce. I was a little surprised that we didn't hear from the tort lawyers in this matter. Maybe we will later.

PROFESSOR PIERCE: I think they're waiting for the money cases.

MR. BARDEE: Mr. Rygh?

MR. RYGH: Good morning. My name is Gary Rygh. I'm a Vice President of Morgan Stanley. I work in our global power utility group, which is to say, I spend my day finding ways to find capital for companies like American Transmission Company, who have asked me to be here today. I, also, do a lot of strategic work, mergers and acquisitions, in the industry, mostly focused -- almost exclusively focused on electric and gas utilities in the United States.

As you, I'm sure, have all read and seen, not only has this been a very interesting time over the last

year, two years, in the capital markets for every industry, it's been an unprecedented time for the utility industry, as some of the contagion of other industries have borne down on what used to be -- you know, widows and orphans type investments. We've seen an industry, which was stable and almost viewed as risk free, turn into one, which people really have issues with: the transition to a competitive market, power and fuel price volatility, accounting discrepancies, rating downgrades. You've seen bell weather companies, like Allegheny Industry, Texas Utilities, have fallen on incredibly tough times, and that's just the beginning of the list, incredibly tough times raising capital, finding capital, paying exorbitant rates. Trying to find the right market clearing price for capital now is, for our utility clients, has become quite a task.

When we look at this issue from a pure capital provider standpoint, we see it as classic risk versus return analysis. We have an industry, which I don't think, at this point, is fully appreciated. This particular issue is not fully appreciated by Wall Street. What could possibly happen, if there was a severe outage and there were trials and legal cases in the first independent transmission company, who is faced with hundreds of millions of dollars of potential damages, on a relatively small rate base is going to find themselves in a unique position. And not only

will it cause severe damage to the ability to raise capital and the cost of capital for that particular entity, it's going to be applied to all new capital coming into the industry and coming into new companies, as they form.

So, I would just say that I'm here for the American Transmission Company, on their request, but this is -- as we look at new companies and new ideas of separating the transmission from the integrated utility, this is going to be something that we see come up again and again.

What is the potential issues with not having the standard protections for the standalone transmission company? I would say, from a Wall Street perspective, it's unclear, and that's probably worse than knowing -- not knowing is having a definitive answer. I think there's a lot of debate here on this panel, on whether or not the states cover the liability; whether it should be federally mandated. That type of confusion and questions is actually worse than the problem, itself.

Once this issue is fully vented, as these companies, like ATC, mature in the capital markets and begin raising more and more capital in the public domain, and this comes more into the light of what this can possibly be, it's going to be quite an issue, unrestrained potentially liability where it didn't exist before. I would just go back to say that Wall Street does not appreciate what this

issue could possibly become, at this point.

So, you don't see it in the cost of capital now; but the first sign of it, you'll see it and it will be borne by customers. Or if it's not borne by customers, it will then have to be shareholders and the companies, themselves, and that's going to limit their ability to raise capital. And what we've learned in the last 18 months is this is not a -- we've gone from a market, I wouldn't call irrational now, it's more headline risk than anything, where we can see incredibly wide swings in the ability to -- the cost of capital, the ability to raise capital, whereas there's no -- it's sort of shoot first, ask questions later type mentality, with the cost of capital. On Wall Street, now a days, you'll see the reaction before the explanation is fully out there.

So, I'd be happy to answer any questions based on that. I would just say that, as we look -- Morgan Stanley looks to be providers and help companies like ATC raise capital in the future, as they look to do what, I think, what FERC wants them to do, expand, become independent, this issue is going to be focused quite large in investor's eyes, as they think about what is -- the returns that transmission provides are not great enough to outweigh unlimited risk. And unless we can find a way to grow earnings at 25 percent, we need to craft an industry that has the same fundamental

protections it's had for so many years. So with that, any questions you have.

MR. BARDEE: Thank you, Mr. Rygh. Chair Cartegena?

CHAIRMAN CARTEGENA: Good morning and thank you for this opportunity to address you. And I want to apologize for my late arrival. As you know, today's weather has been somewhat of a challenge on many different fronts.

I just want to share some brief remarks with you this morning. And as I consider this challenge, I approached it much the way I do many others, because I always try to formulate a picture. Many years ago, someone said, if you want to communicate clearly, communicate in pictures, because that's what people think. And as I did so, I got this picture of Lady Justice and the scales and what I saw was, on the one hand, we have this issue -- in regards to this issue of liability, on the one hand, we have the issue of cost. We, certainly -- I, certainly, am one of the many state regulators, who applauds this Commission for its vision and for its understanding of the need to create an environment, where there will be investment attracted to transmission building.

And what I saw on the other side of the scale is the issue of safety, and that is really what -- that's really the sort of contra force, if you will, that we're

talking about here. And so, in that spirit, I simply have these few remarks to make, which is that on the one hand, if we do want to create an environment, where investment transmission is going to happen, on the one hand, we need to have uniformity. There has to be a standard of liability that applies all across the country. And so, in that regard, I advocate that many of my sister and brother regulators seriously consider supporting a provision in the SMD tariff and that we recognize the importance and the appropriateness of allowing for it to be the body that regulates in this particular area.

I know that we all have different concerns in our respective jurisdictions regarding our rate payers, our residents, and our businesses. But, I just don't see us creating an environment for investment, if there is not rule, in this regard, that applies to all the land.

Connected to that issue of uniformity, of course, is choosing a level of appropriate liability, something that balances the need for us to create a "safe" investment environment, on the one hand, but on the other hand, recognizing the importance of there being some stringent and serious consequences to those instances where transmission builders don't act safely, which leads into my second point.

And that is that in an environment where you wish to have a limited liability, it is important to have a level

of protection with regards to safety standards, that the public will feel comfortable with and that will achieve and accomplish our goal of making sure that not only our energy companies in this country providing reliable service, with safe service. And, of course, as you know, this means having, first of all, very clear and precise safety standards; and, on the other hand, making sure that there is enforcement of those standards, to the extent that there are no incentive for companies to skip on those standards.

So, as I approached this issue with a regulator's mind set, those are pretty much the things that I think we need to look at, as we engage in a discussion about where we want to be with regards to liability.

MR. BARDEE: Thank you, Chair Cartegena. Let me begin by turning it over to my colleagues for any questions they may have.

MR. O'NEILL: Let's just, for the sake of argument, suppose that we put liability provisions into the tariff. ATC seems to think that \$500,000 should be the limit, I assume per event, should be the limitation on liability. That sounds to me like the cost of a good maintenance crew. How do we go about figuring out how to balance these things? That seems to be a little bit cheap, as far as I can tell, because, you know, if you basically give them \$500,000 worth of liability, they look at the

profits and they basically cut back on the maintenance crew. And we're very concerned about reliability here and we want to keep the incentives. We don't want to make -- I don't say we, but making the liability infinite is certainly not our objective. But, the question is how do you design a good liability provision that essentially creates all the incentives to keep the system running reliably?

When I see gross negligence, it starts to scare me, because gross negligence, if you have an outage, can be very serious consequences. And as far as I know, we have a very well documented history of outages and why they occurred and NERC, I believe, and Dave can correct me, if I'm wrong, does very detailed analysis of what cause the outages and things like that. So, there should be a history for the insurance companies to focus on.

But, I look at what people are suggesting in here and it seems that they don't want any liability at all, which would tend for me to think there is going to be a compromise for liability.

PROFESSOR PIERCE: There are people on panel two, who will put a lot more time and energy into trying to puzzle out the question of the proper balance than I have. So, I urge you to ask the question again when the next group gets up here.

But, I'll give you my take. And I should add a

caveat. I was asked to speak here today by EEI, but my views don't necessarily correspond with those of the EEI or its members. I'll give you my views. I think that there are lots of incentives for the transmission owners and controllers to do the right thing. I'd start by responding, at least implicitly, to what I understood to be one of Chairman Cartegena's concerns, that, at least in my view, a limitation of liability should not apply to personal injury. So, if something happens that causes personal injury to someone, I think that should be excluded from the scope of any liability limitation provision. I think those are sufficiently manageable financially, that I'm not troubled by utilities being fully exposed to those risks.

MR. BARDEE: When you say that, Professor Pierce, do you mean, would you include personal injuries that are a result of loss of service?

PROFESSOR PIERCE: I would want to draw the line between direct and indirect damages. I think the potential for some cascading series of unfortunate events -- in fact, I once included on a tort's exam, the typical torts professor's first, first, there is an outage; then there is, about nine steps later, the whole world exploded and the question is, was the utility -- and I would want to draw the line at direct injuries, rather than injuries that happen through indirect chains, because, there, the potential

liability escalates quite rapidly.

MR. BARDEE: So, if I understand what you're saying, then, if the company was responsible for some negligence by somebody driving a car, one of the company cars, and somebody got hurt as a result, this issue wouldn't protect them. But, if they caused an outage and somebody, as a result, lost their heating in a cold winter day and, as a result, suffered harm or death even, this limitation would not -- would protect them from damages in that scenario?

PROFESSOR PIERCE: Well, that second one actually is one I hadn't -- I haven't formulated my views quite in that detail. I was thinking more in terms of a distinction between, say, somebody, who is electrocuted, as a result of a transmission wire that falls. I would say the utility should not be -- the transmission owners and controllers should not be insulated from full potential liability in that situation. But, where it's indirect, in the sense of - - well, you run out of food, because all of the food in your refrigerator was spoiled and you race out to the store to get and you skid on the ice, okay, I mean, tort lawyers are wonderful at figuring out how to get to the deep pocket. I definitely draw the line before we reach that point and draw it on the basis of direct versus indirect.

Other points to consider here and sources of incentives, gross negligence, it's better to have -- from

the perspective of a company, it's better to be subject to a gross negligence standard than a straight negligence standard. There's no question that helps. But, we're talking about differences in degree here. Gross negligence, people are determined by juries all the time to have been grossly negligent in what they did. One famous judge, 50 or 60 years ago, was asked, well, what's the difference between negligence and gross negligence. He said, well, it's a difference between negligence and damn negligence. It's just a characterization that says, if you did something we think is really bad, then you're liable. So, the gross negligence standard that I think virtually all of the proponents of limitations of liability provisions are willing to accept, provides a pretty powerful incentive for them to do the right thing.

They have lots of other incentives, as well.

They have public relations concerns that are non-trivial. They have government relations concerns. You will not be pleased with them, if they do the bad thing, the wrong thing. State commissions that may not regulate them in the context of transmission, but have lots of power over them in other respects will not like it, if they do the wrong thing and bad thing. They're well aware of that and they are going to take all of that into consideration, in figuring out how to operate and how much money to put into

maintenance and the like. And then --

MR. O'NEILL: Isn't it better to know what your liability is, as opposed to basically having this sort of unstated liability that the -- the Commission that regulates you may change your rate of return or may get angry at you and change your depreciation schedule, in ways that you have no idea about?

PROFESSOR PIERCE: That's an interesting question. I guess my initial response, at least, is that it depends on how much money we're talking about. And when we're talking about tort liability, as you undoubtedly know, there's been a lot of studies done of the potential tort exposure of owners and operators of transmission lines, and it's very difficult to estimate that, and the studies are all over the place. But what they all agree on is, we're talking very large numbers. We're talking about potentially billions of dollars. Most regulators don't change your ROE by enough to nail you for a billion dollars or put you into bankruptcy.

MR. O'NEILL: I guess the objective I'd like to get to is to get enough certainty into the process, so that Morgan Stanley and the insurance companies can actually get comfortable with standards that create the incentives for a reliable well-functioning transmission system without breaking the bank, so to speak. So, we could argue --

although we don't know what the number is, we could argue for some cap on the limitations. If we have a cap on limitations and we say, since you say there's no difference between negligence and gross negligence, let's just go with --

PROFESSOR PIERCE: Oh, I didn't quite say that.

MR. O'NEILL: Oh, I thought you did. I thought you said --

PROFESSOR PIERCE: No, I didn't.

MR. O'NEILL: -- it's in the eyes of the beholder.

PROFESSOR PIERCE: No. I said, as a famous judge once put it, it's the difference between negligence and damn negligence. Sure, it makes a difference. The jury gets a different set of instructions and the judge uses different standards in figuring out whether to direct a verdict. But, it still leaves you in a position where, if you do something bad, you are vulnerable to large losses.

MR. O'NEILL: Well, let me be more specific. Every week, we see Homer Simpson on T.V. That act at the beginning of the program, is that negligence or gross negligence?

PROFESSOR PIERCE: I have to say, I've missed Homer's act, so --

MR. O'NEILL: You've never seen the Simpson?

PROFESSOR PIERCE: -- as part of my education that I'm sorely lacking. And I don't think he's joined EEI yet, but I'll have to check. I don't know.

MR. BARDEE: Mr. Corneli?

MR. CORNELI: Going back to Mr. O'Neill's question, I think the two issues that are like vague parameters of this discussion are the needs of the RTOs essentially for insurable, which is what I heard the other panel as saying, and this is represented in the affidavits that they submitted in the MISO original proposal, is well, are things like, we don't know what our liability -- we don't know what our customer's liability or risk in expected out-of-pocket expenditures for liability may be. So, we're going to come up with a really high premium for your insurance policy. We can't get an actuarially fair number, because we don't know what the risk is, we don't know what the financial risk is. And then on the flip side, there's been the argument made that \$500,000 or 25, 10 thousands of the transmission owner's annual revenue is fine to provide an incentive for the transmission owner, to take care of the safety and the commercial vulnerabilities that they could impose on people by being negligent

I think somewhere between this unlimited knowledge, you know, the sky is the limited, in terms of what it might cost us, is what I hear to get insurance and

this minimal amount, which I agree looks like a very small amount of money, that is sufficient to provide an incentive. The right answer probably lies somewhere in between there, in terms of what the actual cap should be.

Now, I don't really know how -- EPSA and NRG don't have a recommendation, in terms of what those numbers should be. To get there, I think that the questions that you have asked the second panel, questions eight, nine, and ten, I think would give an idea of the tradeoffs, in terms of insurance, self-insurance, rate impacts. What they really don't get to, I think, is the incentive characteristics. And, as Professor Pierce points out, there's many other drivers of incentives for responsible behavior in the industry. But, nonetheless, I think it is something that you ought to address.

What I'd like to say is that I think that there's a kind of interesting categorization here of where the limits could be and what they should be of. One is, should they be for direct or indirect; should RTOs and TPs, and, in our view, generators be shielded from liability for indirect damages, consequential damages, or direct damages, or both. And then the other line in the box is negligence versus gross negligence.

Now, like Professor Pierce, I can't say this on behalf of all of EPSA, but I certainly can say it on behalf

of NRG, we see problems with going to anything other than a gross negligence standard, just because of the huge proliferation of potential liability that can come from simple negligence. And the fact that all these ITCs, IPPs are predominantly non-profit organizations and any damages that they end up paying out or premiums they end up paying out end up in everybody's rates, as well. So, there's some sort of natural limit, in terms of the amount of money you want to have flowing through the system, that a gross negligence standard could help identify.

The other question, though, is direct versus indirect and consequential damages.

MR. O'NEILL: Can I just ask a question?

MR. CORNELI: Yes.

MR. O'NEILL: I tried to get gross versus simple negligence or negligence sort of out. Suppose you don't do your tree trimming, gross or just negligence?

MR. CORNELI: Well, I think you have ask a lawyer that. I would say that most IPPs don't have a lot of tree trimming to do, so --

MR. O'NEILL: I wasn't talking about the -- I'm just talking about the transmission lines or transmission business.

PROFESSOR PIERCE: I can tell you the answer is based on all the facts and circumstances and it might be and

it might not be and that would be in, I think, any jurisdiction, a question for the jury. And there is an irreducible minimum of uncertainty in potential liability that just is going to be there. Even if you give the folks today, who are urging the most protection you can give them, they're still going to be some degree of --

MR. O'NEILL: But, if we, the FERC, put in limitations on liability, shouldn't we try to be specific as to what we think they mean or what they should mean and give examples?

COMMISSIONER GARVIN: If I could respond to that. In terms of your original question, in terms of whether the \$500,000 per event is reasonable, again, this is a middle of the road standard. This is a standard for simple negligence. And as a regulator, we can't quantify. We could be here all day with economic experts on what the damage claim might be. What we're trying to do and we're urging you to do here is put in a standard that's fixed, so that it provides a deterrent effect. That's what we view, at least in telecommunications and a state level, penalties like this for is to deter, because, as Professor Pierce mentioned, I think, it's going to be a jury decision on how much a claim for consequential damages is.

MS. MARLETTE: Can I ask a question, just back up a little bit and ask it slightly differently and maybe a

little more directly, without getting into discussion of direct, consequential damages? I'd like to poll each panelists. Does everyone here agree that even in circumstances of gross negligence, there should be some degree of liability protection? And I'd also ask the same question with regard to intentional wrongdoing. Without getting into what that protection should be, but that even for gross negligence, there should be some protection in the FERC tariff. If we could just go down.

MR. CARTEGENA: I think that we need to have it. I think, again, if we're going to meet our goal of inducing and creating an investment climate, where companies are going to feel safe investing, I think there needs -- without going to the questions today of what the level of protection is, there should be some level.

MS. MARLETTE: And in that situation, do you?

COMMISSIONER GARVIN: With respect to gross negligence, I think there should be liability imposed --

MS. MARLETTE: Should be liability, not liability protection?

COMMISSIONER GARVIN: Right.

MR. BROWN: I think you can draft the wording to delineate what the gross negligence might be. The better it would be from an insurance perspective, because they're insuring the unknown. As Professor Pierce pointed out, the

very availability of tariff protections does not necessarily preclude extensive litigation and expense being involved. So, I'm not sure I could answer yes or no on whether it should be there for gross, but I would encourage you to craft it as clearly as you can on what you are intending to cover.

May I make one quick comment, while I have the microphone? One of the incentives, I think, you have to recognize that these utilities will have to be responsible as corporate citizens to do the right thing is a very pragmatic one. We're dealing with liability insurance issues here. The other half of that equation is maintaining their facilities, their plant, their operations. It's extremely difficult, if not impossible almost, to buy property damage insurance for loss of transmission lines. To my knowledge, about the only way to do it is in Lloyds of London and it's almost a -- it's called a rate on line. If you want to buy 50 million of protection, you might pay 25 million for premium for that kind of coverage. So, clearly, without the availability of coverage for issues that might cause property damage to their facilities, they're going to be very conscientious about maintaining them and operating them in a safe manner, to ensure that they will be there, so they can make money.

MR. CORNELI: In terms of the question about

gross negligence and liability, I agree with Commissioner Garvin, that there should be, at least, very substantial liability for gross negligence. I mean, that's kind of a fundamental policy precept that's manifested itself in our legal system, is that people shouldn't do really bad stuff and get away with it.

At the same time, I think there is some empirical aspect to whether there should be any limit or not. For example, it seems clear from reading the testimony in this proceeding that there could be, when you combine punitive damages, consequential damages, tort liability, and a whole bunch of other legal items, there could be a lot of damages accruing to a lot of people through a lot of long chains of cause and effect that could become extremely difficult, almost ridiculous, in terms of trying to get them paid for. I think the key think, in terms of the gross negligence, is not to set the very low standards that are set forth, direct damages in the case of ordinary negligence, or that is proposed in the ATC and RTOS proposal.

So, I'd say substantial liability; but whether there should be some pruning of it, that may be appropriate or may not.

PROFESSOR PIERCE: I think that you do need limitations even in the gross negligence context, including at least a limitation to direct versus consequential

damages. I frankly just haven't thought about the issue enough to have views on whether you need additional limitations besides those two.

And I'd also like to respond to Dick O'Neill's earlier question. The more specific that you can be, the better. That's great. But, you will discover rather quickly that there are real limits to that. One of the things that all of us tort professors do every semester is we take our students through a sequence of Supreme Court opinions.

One issued in 1920 established the stop, look, and listen rule and established a very clear rule of when it is and is not proper, negligent or non-negligent, to cross a railroad track. And seven years later, the Supreme Court reversed itself, in an opinion, in which it said, we now know that there are thousands of circumstances, in which people cross railroad tracks, and that there is no simple rule that will allow us to specify when you are reasonable or unreasonable to cross a railroad track without first stop, look, and listen. And so, we hereby take it back and we return to negligence and all the circumstances.

And that's a problem that torts have encountered many, many times. There are real limits on how far you can go. And, fortunately, you don't have to go too far, because there are terms of art that judges are accustomed to

applying, like the difference between negligence and gross negligence, and the difference between direct and consequential damages. And you can go pretty far just by incorporating in your limitation on liability the standards, the vocabulary that judges already use, to distinguish among categories of damage or distinguish among types of behavior.

MR. RYGH: From a capital market perspective, the concept of severe damages for gross negligence is something we are familiar with. When we think about raising capital for this industry, it's the ability to quantify. Where those damages may become is the hard part. I think Professor Pierce has talked about it a little bit here, about there's a whole chain of events that can cause, from what can be viewed as gross negligence, to become very large dollar issues. So, I think in the capital markets, we'll have a hard time, in this particular industry, trying to understand what is the cap; where does it end.

So, I think it would be more than understanding of severe and punitive damages in a gross negligence type scenario, what they would want the comfort of understanding; where is the limit on that. For your purposes, it needs to be punitive, but it shouldn't be one where they can't get their arms around where is the end and something that they can also insure against.

MR. BARDEE: Mr. Brown, I wanted to ask you a

couple of questions about insurance costs and I don't know how specific you can be, in terms of trying to give us an idea. But, we've got a few ideas floating on the table. One is to say that under our tariff, the utilities won't be liable for ordinary negligence. Another is, they're only be liable for direct damages. And a third is to put a specific cap, even when you do allow damages. In terms of the insurance costs that utilities have to pay, is there a way to evaluate what each of those three things do to their costs, if we were to give them a limitation for ordinary negligence, compared to a limitation to direct damages, compared to a specific cap?

MR. BROWN: You would hope that reason would prevail and that you could explain to the underwriters the value of these cap limitations that you're going to provide. And, yes, they do have a very positive effect on establishing pricing. Again, there is still a realm of the unknown about what can happen when it gets to court and that's, again, where they have their problem in actuarially determining what they really should charge.

But, any discussion, negotiation with an underwriter about what is a fair pricing, that clearly will be a critical part that would be in the favor of the insured utility, to say that your pricing model doesn't make sense for me; I have these limitations. And we have seen those

have effect in state limitations, so they should certainly have effect in the federal limitation.

MR. BARDEE: I would expect so, too. But, is there someway to get an idea of -- not that these are mutually exclusive, but if we were trying to figure out which was the most important limitations we could address, would it be to say direct damages only? Is that more important than, say, putting a specific cap on, in terms of minimizing insurance costs?

MR. BROWN: Well, that's a very difficult question to answer. Again, it goes to modeling of potential losses and what would this consequence result, if you were dealing with caps on this, versus direct damages, consequential, what have you.

Unfortunately, as maybe I'm letting a small secret out, insurance pricing is not quite the science that some people think that it is. There is a bit of pulling it out of the air. But, there is reason, there is rational, and what the market will bear. And all I can say is that the more information that one has going in and sitting down and talking with an underwriter about what this account really is worth, the better the end result. And these limitations clearly are a very strong incentive for underwriters to look positively on an account.

MR. BARDEE: Professor Pierce, I had a question

for you. It's been many years since I was in law school and studies tort law. And since then, I've just done energy law and don't know anything about this. Under 888, we said that we were going to leave it to state tariffs and state courts, to determine liability of limitations. And I accept for the moment that with the restructuring that we've encouraged and that's happening, some utilities, at least, will find themselves without the protection of a state tariff anymore. But, there's always a state court. Can a state court do the kind of balancing of safety and risk? Can they do -- what I thought I vaguely remember Justice Cardozo doing years ago, saying, well, we've got to balance all of this and because of that, we're going to say, the harm to party has to bear this risk. Can they adopt the kind of limitations that people are suggesting we should adopt?

PROFESSOR PIERCE: I'm very skeptical that they'd be able to do that. Institutionally, they don't have the kind of perspective on the transmission function and its significance to the performance of the electricity market that this Commission has. I was just talking with Dick O'Neill before today began about -- I asked -- actually, I think I asked you, Mike, who has the record, in this case, and where is it physically housed, since it has to be massive. I have the misfortune to be on the service list, so I'm aware that it's massive. A state judge isn't going

to get all of that. A state judge is going to get quite different and far more limited and far more parochial information.

And then, of course, under our legal system, the state judge only goes so far before he hands it all over to a jury and say, you're the folks, who do the balancing. Well, the likelihood that any jury is going to obtain the expertise that this Commission has about the electricity market and the relationship between the potential liability of owners and controllers of transmission facilities and the performance of the newly restructured electricity industry, well, it's unlikely that any judge or jury would be able to do the kind of careful balancing that this Commission could do.

MR. BARDEE: Well, when you say that, I mean, as I indicated a minute ago, we do energy policy here and we have a hard enough time figuring out what the right energy policies are and how to make markets work. But to put us in a position of deciding questions of tort law and, you know, should it be gross negligence versus negligence, I mean, I'm not sure that we're the right entity to be making those kind of calls.

PROFESSOR PIERCE: I'm certainly not suggesting that you should be making the call as to whether a particular aspect of behavior in a particular situation is

negligence or gross negligence. I do think that you're in a much better position to make the call as to whether a standard like gross negligence should apply to the range of conduct at issue than is any state court or jury.

COMMISSIONER GARVIN: The one practical point, I guess, from a regulator out in the Hinter land, having gone through a lot of litigation over siting, do you really want to leave this risk assessment -- for example, Illinois has argued that they should preserve their jurisdiction -- do you really want an elected official in a community, who may or may not be affected by an outage, helping provide the risk assessment? And I think if you do it state by state, you're adding incredible uncertainty. You're adding political considerations.

We have seen first hand on siting, you know, how difficult it is to do litigation in a small county in the State of Wisconsin. And I think you're really multiplying the practical problems, unless you provide some certainty at this level. I mean, we've accepted your invitation by operation of state law. We're in this and we desperately need some certainty, and either simple negligence or whatever. But, we're pleading with you to provide some certainty, because, other than that, you're taking the vulcanization of this type of risk assessment to a new level.

PROFESSOR PIERCE: Can I just add that I agree completely with Commissioner Garvin on that. And if you want to a wonderful book that details the way in which parochialism and politics winds up playing quite important roles in the world of tort law, a former West Virginia Chief Justice Nealy wrote a wonderful book about 10 years ago, explaining why, in a West Virginia court, West Virginia plaintiffs get money from out-of-state corporations all the time and why he, as chief justice, was never about to stand in the way of that and what might happen to his prospects for reelection, if he did. And so, I mean, you can't solve all of those problems. But, it's something to take into account before you go too far in trusting that state torts are going to be able to get the right answers to these very complicated national questions.

MR. BROWN: As federal regulators, we certainly understand the wisdom in trusting policy to Washington. But, you often hear the argument in Washington, and it doesn't come often here at FERC, that we really ought to leave these decisions closer to the regions, to the locality, to the people.

But having said that, I did want to ask Commissioner Garvin and Chair Cartegena, if you know, what kind of limitations you're commissions have in the tariffs that are within your jurisdiction for state service? Do you

limit liability for ordinary negligence or to direct damages, if you know?

MR. CARTEGENA: I think, if I recall correctly, our tariffs here, the standard is gross negligence -- well, actually, negligence is for gross and willfulness conduct or negligence, something along those lines. But, that's the standard, essentially that. I think they're contained in all three of our incumbent companies tariffs.

COMMISSIONER GARVIN: Well, if I was in Professor Pierce's law school class, I'd say pass here, since I haven't had a chance to look at all the different tariff provisions. I would tell you, though, that the provisions under our -- we have not been a model of consistency, depending on what's formerly under bundled service when they were integrated. There were different liability limits, but they were there. That's why I would say, with respect to the simple negligence standard that ATC has offered, my understanding is significantly higher than what -- you can ask this to Mr. Doyle this afternoon or whoever is representing ATC. They may have a better answer to that. That's why, I guess, my point earlier was that I think it is a significant limitation. I mean, whether you go from half a million up to a million, that's ultimately going to be your call. But, we have not been a model of consistency in Wisconsin, but this is an effort to try to do that.

MS. GADANI: I just have one question. Earlier, Mr. Corneli, you talked about extending the protection to competitive supplier type industry. Nobody has said anything on that. Do you have any input on -- anybody on the panel, on -- we mostly heard or seen provisions that protect transmission providers and then extend that to transmission owners, often to transmission owners acting under the directive of the transmission provider. So, does anybody have a comment on extending this protection to generators, marketers, who are acting on the directive of the transmission provider, et cetera? If you don't care, we can do that, if that's okay with everyone.

MR. CORNELI: If I can just say one thing about that. RTO West proposal actually has a fairly exhaustive list of -- you might say anybody and everybody, who could be implicated in transmission service interruptions or imperfections, and that seems like a good idea.

PROFESSOR PIERCE: I haven't given enough thought to that question to have a definitive answer. But, I would urge you to think about two different things. One is, I completely agree with Mr. Corneli's evaluation description of Sally Hunt's submission on this general issue in the MISO case, and I hope somebody submits that in the record of this proceeding, so that it's available to you. She's identified some very important considerations there. And at least some

of those apply, as well, to generators.

On the other side of it, though, one of the reasons why I think there's a very strong case for providing a degree of protection from tort liability to transmission owners and controllers is because they are required to provide service to everyone on standardized terms. They do not have the option, as to most participants in unregulated markets, to say, well, you're too risky, I won't do business with you; or you're so risky, I'll do business with you, but only if you agree to some limitation on liability or some way of allocating. And I know that that consideration is true for all transmission owners and controllers. I don't know the extent to which it is true of generators. And it is, I think, an important factor to consider in your decision-making.

MR. BARDEE: I had one other question I'd like to ask, just to make sure I've got the right assumption here. In terms of administering this, one of the questions we had in the notice was how do we administer it, and I've always assumed that even if we adopt liability limitations, let's say a limitation that says no liability for ordinary negligence, that we would not then later get litigation here at FERC, where we had to figure out, well, what does ordinary negligence mean, the kind of question Professor Pierce was making. Is that what you all are assuming? Or

does anybody envision or expect that we're going to have future litigation here in actual cases involving claims of harm that FERC will be adjudicating?

PROFESSOR PIERCE: I am confident that you will not have that litigation, though I would expect that there will be people from time to time, who will attempt to put you in that position. Whoever thinks that they are likely to be disadvantaged in a tort case is likely -- at least has an incentive to ask the court to invoke the doctrine of primary jurisdiction and to send at least some of the issues to the expert agency that authored the tariff that's at issue.

I teach and write about the court cases involving the application of the primary jurisdiction doctrine to tariff disputes, disputes about the meaning of tariffs. And you're in good shape, in terms of fending those off and saying, no, those are appropriate for the courts.

The courts like to invoke primary jurisdiction for good reason and to send issues of tariff interpretation to the agency that approved the tariff, when the tariff is very complicated, very technical, and when there are unanswered questions about its interpretation and application in a particular situation. But, in a case of this type, where the tariff uses common law terms, like gross negligence rather than negligence, direct damages

rather than consequential damages, and doesn't use any highly technical terms taken from the world of electricity, unique world of electricity, you're in very good shape to say, oh, no, any state or federal court is well equipped to handle these disputes. There's nothing -- we've already said all we need to say about the terms on which those disputes should be resolved.

MR. CORNELI: I think just from the experience of spending in an earlier part of my career, years watching things come into a state attorney general's office and regulatory commission and the courts, my only advice would be, I think very consistent with Professor Pierce's, is to be scrupulously careful about the language you actually put in the tariff. I would note just from a non-lawyer's perspective the ATC language, where it says -- discusses the limitations on damages, uses the passive voice in a spot and says, notwithstanding the complete limitations on liability in the previous section for each incident in which transmission owner is found liable for damages. And to me, at least, that raises a question of who is going to do the finding and whether that's going to be you or a court. And I don't know if Professor Pierce cares to comment on that specific thing, but I think the principle of making it very clear what you're going to do and what you're not going to do and what applies and doesn't apply in the tariff is

probably a good one to avoid finding out that you do have litigation here that you thought was going to take place elsewhere.

MS. MARLETTE: Produce litigation is bad enough. I don't think we would handle this very well. Could I just -- I think we're about to wrap up, but just to be very clear for the record, another poll. My impression from all of you is that you support a uniform nationwide standard from FERC, not -- I know, Commissioner Garvin, you, at a minimum, supported a regional standard, so that you didn't have different standards within MISO, itself. But, does everyone here support a uniform standard, rather than the Commission trying to do this on a regional basis?

MR. CARTEGENA: I would prefer a national standard. I think it's what makes sense. I think that we're talking about building a national grid, however we get there, through regionalization, whatever. On this issue of liability, I think there needs to be nationally uniformity.

COMMISSIONER GARVIN: I've already said my piece on that.

MR. BROWN: I think since you're dealing in an insurance marketplace, it's a national marketplace, obviously, a national standard would be to the advantage in that.

MR. CORNELI: I think a national standard is

important. There's a question that you ask for the second panel, I believe, whether it should be -- whether that should be the highest of or the lowest of various standards, and I think that -- my view is that the lowest of it might be the most appropriate, rather than the highest of. In other words, provide a uniform floor and if there are some states or jurisdictions that have exceeded that or choose to exceed that, that might be all right.

PROFESSOR PIERCE: I definitely support a single national standard for many reasons.

MR. RYGH: A single national standard is what provides investors the most level of comfort, especially as these transmission organizations begin to cross regions. So, we definitely would support one single standard.

MR. KELLY: Good morning. Just one other question. The standard market design proposal not only requires a transmission operator to provide transmission service, but also to establish spot markets for power. And that seems, to me, to raise a question about whether the same liability standards or provisions apply in both cases, to the provision of transmission service, as to the operation of a spot market. Not only are they apparently different services, which arguably could require different liability provisions, but also where the annual throughput in the transmission service's market might be measured in

millions of dollars, it's potentially measured in billions of dollars for the throughput of the spot market. And so, I guess the question is, is that a difference in degree? In kind? And would language that's adequate for the protection of companies that provide transmission service, serve equally well for the provision of the spot market service?

PROFESSOR PIERCE: I'm going to try. Frankly, I always get nervous when called upon to make a speech. But, I'm going to try anyway.

I think that the same consideration would apply to the operation of the spot market, as applied to the operation of the transmission system. Particularly, a person, who operates the spot market has no discretion to decline to deal with someone or to say, I'll only deal with you, if you give me some limitation on my potential liability. So, off the top of my head, I would think that the same factors would apply and that -- well, perhaps what's necessary is thinking about exactly what kind of language in a tariff would accord the same degree of protection to an entity, who operates a spot market, as to any entity that owns or controls a transmission line. I think that's important.

MR. CORNELI: I just observed that there's at least one fundamental difference between the spot market and the transmission system, at least our supplier's

perspective, which is that if the transmission line are out between me and all of my customers, I can't run my plant. If the spot market is not working properly, I can go bilateral. I may not be able to go bilateral today, but I can go bilateral tomorrow. So, there's a much different degree of substitutability of modes of transaction in the case of the spot market, at least for many of its functions, than it is in the case of transmission.

If I recall correctly, either PGM or New York ISO -- I believe it's PGM, the member's agreement addresses liability, and members agreeing not to basically sue PGM for problems associated with the spot market, or at least some type of -- shed some liability regarding that. And that may be appropriate. But, I suspect that the differences between transmission and spot market operation are such that the same language and the same standards may not be appropriate for both. It certainly merits further thought.

MR. BARDEE: I'd like to thank our first panel. We've run a little bit long. Why don't we take about a 10-minute break and come back around 11:20. Thank you all.

(Whereupon, at 11:00 a.m., the hearing was recessed, to reconvene with the second panel at 11:20 a.m. this same day, Wednesday, December 11, 2002.)

MR. BARDEE: As with our first panel, all the panelists should feel free to make an opening statement and after that, we'll have questions from us and any interaction among you all.

Mr. Coleman?

MR. COLEMAN: Good morning. My name is Walt Coleman, I'm associate -- excuse me, assistant general counsel at Duke Energy Corporation, Charlotte, North Carolina. I'd like to thank the Commission and staff for the opportunity to present Duke Energy's views regarding limitations on liability.

Duke Energy is a diversified company with a broad array of energy assets. We appropriate approximately 14,000 megawatts of merchant generation and we're also one of the Nation's largest electric utilities serving both retail and wholesale load for approximately 2 million customers in North and South Carolina.

We have developed specific tariff language regarding limitations of liability, indemnity and force majeure which we presented as part of our November 14th S&D filing. The following five principles guided Duke Energy in developing these provisions.

First, all ITP tariffs should allow for certain limitations on liabilities for acts or omissions which are associated with performance under the S&D tariff. Such

protections will reduce uncertainty as to liability for ITPs which should, in turn, result in reduced cost to ratepayers for lower insurance premiums, less litigation and reduced exposure to potentially large damage claims which may not be reasonably insurable.

Limitation on liability for actions other than those performed pursuant to the tariff will continue to be governed by State tariffs to the extent applicable or by other State or Federal laws.

The second principle is that Duke Energy believes that such limitations on liability should extend not only to ITPs but also to transmission owners, generators, and other entities which those entities are acting at the direction of the ITP. Without such an extension, we believe these entities are likely to become the natural targets of those seeking compensation or damages related to service interruptions under the ITP tariff.

Third, we believe there should be a broad limitation on liability for consequential and incidental damages.

Fourth, we think that direct damages should be capped at a reasonable monetary limit, except in the case of gross negligence and intentional misconduct, in which case we would recommend that there would be no cap on direct damages; there would be a cap on consequential and

incidental.

We had hoped that the first panel this morning would provide some assistance to the Commission in setting the appropriate monetary limits. Unfortunately, we have a panel full of lawyers here, so I'm not sure we are going to be able to provide some of the guidance you may want on some of the risk management and liability provisions. We do think from hearing from the first panel this morning that it is important that the Commission talk to underwriters and other risk management experts who may be able to provide you additional guidance on the cost for insurance and that will help you in setting the reasonable and appropriate caps.

Duke Energy believes that if the liability caps are set too low, they may not provide adequate remedies for entities that are harmed by service interruptions and they may also not provide the right incentives for the ITP and those acting at the ITPs' direction.

Conversely, if the caps are set too high, the ITPs and those acting at the ITPs' direction will face significantly higher insurance premiums which will translate into higher transmission rates. Moreover, to the extent that insurance might not be available to cover these risks the ITPs, which will probably have minimal assets and availability to capital, will be put at a greater risk of insolvency and bankruptcy.

And the fifth and final principle that we used in providing our tariff proposals is that liability provisions should be uniform throughout the country and should reflect typical commercial practices.

As I wrap up, I do want to make a couple of comments based on this morning's panel. There was a question asked as to whether the courts should fashion liability sua sponte on their own. I guess our position is that the courts could not. The tariff will be basically a part of a contract. You will have a participating generator agreement or an interconnection agreement. You will have tariff provision incorporated in that. It will be a binding contract between two parties. If there are no liability provisions in that contract, we don't think that the court can step in and impose arbitrary liability limitations on the parties.

The jury, I guess, could always come in and in their judgment increase or decrease the amount based on what they think the damages are. But we don't think the court should set an arbitrary limit on their own.

And one final comment. As part of our filing we did propose tariff language. We noticed in the notice that was sent out by the Commission that there was an error in the indemnity provision that was submitted as part of the notice. It is correct in our original filing and we have

also circulated a draft here today which is correct.

Thank you.

MR. BARDEE: Thank you, Mr. Coleman.

Ms. David?

MS. DAVID: Good morning. Thank you for allowing me to participate today. I'm here to speak on behalf of the Edison Electric Institute. I am from Commonwealth Edison, which as you all know is a subsidiary of Exelon Corporation. We are an integrated public utility company and we own both transmission, distribution, and -- we have transmission and distribution and we have a generation affiliate.

We fully support the EEI position that neither an independent transmission provider nor the transmission owner, nor for that matter, any independent transmission company that is exercising any functional control over a transmission system, should be liable to third parties for money damages except to the extent of that particular actor's gross negligence or willful misconduct.

There should be no liability for indirect, consequential, or special damages including lost profits. These types of damages are potentially ruinous and are traditionally excluded in commercial agreements.

However, the limitation of liability should not preclude actions seeking only declaratory or injunctive

relief or other equitable remedies. These kind of actions don't call into play the same kinds of considerations that are traditionally raised as arguments against claims for damages. For instance, that an independent transmission provider can be bankrupted by the claim or that the costs will simply be socialized across a larger load. So we believe that these remedies should definitely be preserved.

The traditional argument against limitation of liability -- and we've heard it here today -- is that there is no incentive for the person who has no liability to act with due care. We would strongly disagree. We think there are strong regulatory incentives, rate incentives, and frankly financial incentives if your lines are not up. If your lines are down, you are not making money. If you are not transmitting electricity, you are not making money.

We also think that the right to bring declaratory actions, the right for parties to bring declaratory and equitable actions against either a transmission provider or a transmission owner will also provide some of the discipline that the Commission has noted may be missing.

With respect to State law protections, the State law protections have traditionally been there, but as the previous panel noted these entities that we are discussing now, independent transmission providers, transmission companies, are not State-recognized entities. They are not

going to be subject to the State tariffs in the same way that a traditional integrated public utility company is subject to the tariffs.

We have some significant concerns that the transmission owner will become the "pocket of last resort" for a plaintiff who can't achieve what it needs from a transmission provider if the transmission provider either has no assets and has its own exclusion of liability, and the same protection is not extended to the transmission owner.

But in any case, we believe that it's very important that this limitation of liability apply to both the independent transmission provider, the transmission owner, and any independent transmission company that may exercise control over the transmission grid.

Where a transmission owner or a transmission company is only following the independent transmission provider's instructions or acting under the tariff, it should have the same protection that the independent transmission provider enjoys.

We, unlike some of the other panelists you are going to hear from, do not support a cap based on a lower threshold of liability. We think a cap is an unworkable concept for a number of reasons.

We think that the structure of a cap and setting

the amount of a cap is extremely problematic. If you have a per-incident cap, you have to be concerned that there may be a number of incidents. And you again have the same problem that the independent transmission provider is likely to be a not-for-profit entity, has no assets, and isn't going to be able to satisfy more than one claim or may not be able to satisfy all the claims even under the cap. You create an incentive to have a race to the courthouse to reduce your claim to judgment to have a piece of a capped damage amount.

We are concerned that a cap is unworkable for that reason and for a number of other reasons.

Significantly, I think you have to keep in mind that to the extent that an independent transmission provider is a not-for-profit entity and has no assets, it's always dealing with other people's money. The only way that the independent transmission provider will pay that claim is by raising its rates, which merely means shifting the cost of the claim to someone else's load.

The customer in question who may have been damaged probably had the ability to insure, but the person who now has to pay the higher charges for the ITP doesn't have that ability.

In any case, at the end of the day the liabilities that an ITP pays or an independent transmission provider pays will simply be socialized. I think that we

need to leave the liabilities where they can be insured, which is at the customer level.

Thank you.

MR. O'NEILL: Could I clarify for a second? The ITP could get insurance, couldn't it?

MS. DAVID: It's not clear that the ITP can get enough insurance to be meaningful. I think that that's what the MISO was arguing in its original filing. The ITP can get insurance, but the cost of that insurance simply goes to the load.

MR. O'NEILL: But can't nonprofits get insurance? Your testimony seemed to be very directed at nonprofits. They can get insurance.

MS. DAVID: Nonprofits can certainly get insurance. We have heard from the previous panel that the cost of that insurance may be significant and it has, I think, limited value.

MR. BARDEE: Mr. Doyle?

MR. DOYLE: Good morning. Thank you very much for allowing ATC to appear before you today in its various personages.

I will start out with just some general comments. Number one, ATC is a transmission-only, limited-liability corporation which operates in the State of Wisconsin and Michigan under -- and parts of Illinois under no State

tariffs whatsoever. We provide service only at a wholesale transmission level under the OATT.

We own no generation, no distribution, and, in fact, are precluded by law from owning those inside the State of Wisconsin and we're involved in no energy merchandising activities. We have, like many other nonindependent Tos, transferred operation of our facilities to the Midwest ISO.

We believe that overall, limiting liability represents sound regulatory policy for a number of reasons. Number one, this is a concept that is widely accepted in State tariffs, albeit an array of approaches but the concept is well grounded as Professor Pierce talked about this morning.

One of the other things that I think is important about it is that it also reduces rates and we talked about that sort of tangentially. But if you take one side of a bookend and we say we are going to have no limited liability for direct damages -- let's leave for the time being the gross negligent concept out of the equation -- you virtually eliminate from the regulatory model all insurance costs, because basically the policy takes away the need for insurance for that particular peril. You don't have legal costs. You don't have potential damages. And you don't have the ramifications on capital costs which depend upon

whether or not damages are going to be includable above the line or do they have to go below the line and make your returns to equity issuers more risky.

On the other end of the spectrum is no liability limitation, and basically what you do is you open the regulatory model to a bunch of costs that don't absolutely have to be there. And you have that decision sitting before you.

We also believe that the insurance markets are very soft. We don't believe that insurance will always be available. We don't believe it will always be adequate. That depends sometimes on market considerations, it depends where industry sectors are in their risk profiles. But to basically rely on insurance is going to create a regulatory policy that provides coverage one year and doesn't have it next year, and you have the ability to deal with that.

We also believe that the damages under liability considerations are difficult to quantify. They far exceed the value of transmission rates and, as Mr. Rigg talked about this morning, can be commercially and financially unmanageable.

Furthermore, because the regulated nature of our business, we serve everybody on the same terms and conditions at the same price. We have absolutely no ability to charge a higher rate for a riskier customer, nor do we

have the information to be able to do that, as well. That's part of the problem in turning us into compulsory insurers by leaving us exposed to unlimited direct damages is that we have to make decisions for customers without having the benefit of the information that they have as to whether or not they would insure a risk or not insure a risk.

We think that is an unmanageable standard. And we also believe that we should not leave this issue to the courts. One of the things that we talked about earlier was in the earlier panel was the notion of can the states deal - - the State courts deal with these issues, will they deal with them? I am not a lawyer, but I have read all of -- also a lot of information leading up to this, and my interpretation of what is going on is you are a quasi judicial/administrative organization. You have the ability to set standards which are the interpretation of the contract set forth in the tariff. Under the State law and the State provisions that already exist, the State courts have deferred to your judgments -- to the Commission's judgments in those standards and have narrowly applied their adjudication to the questions of negligence, et cetera.

Now on to our proposed liability provision: Number one, our provision that we have filed with you applies only to damages provided from service provision under the OATT. We specifically exclude issues of property

and injury damages such as were discussed in the panel earlier today.

Our provision limits liability for negligence to direct damages up to a stated cap. We have offered you two alternatives. One is a \$500,000 per event or a quarter percent of revenue. I agree with Ms. David that standard a difficult one to adjudicate for all the reasons that she mentioned, which is why we brought up the second cap, the second alternative, which is limiting the amount of damages to the value of transmission over the time period of an interruption or a service imperfection, et cetera.

What that does is two things. It avoids all the problems that Ms. David brought up and also it creates better information for customers to determine whether or not they ought to be insuring against a peril on the electric system. Basically if they can sit back and say, you know, an average outage based on what I have seen is 6 hours, here is the value of my transmission service over those 6 hours, they have got perfect information.

Also it allows us to understand what the ultimate damage will be so we are in a better position to weigh going to court and fighting versus settling, which might be easier in any given case.

There is no limit -- back to our provision -- there is no limit on the recovery of direct damages for

gross negligence or willful misconduct. There was some discussion earlier about whether or not there ought to be a cap. I haven't seen one anywhere, but I would be happy to take one if you would offer it.

Our provision also excludes all consequential and indirect damages. This is an important point because if you listened to Mr. Rigg this morning, consequential damages relate to a plethora of theories and interwoven stories, if you will, to create liability in somebody's pocket. Having us exposed to those kind of damages just leaves us exposed to an enormous amount of uncertainty and in this marketplace uncertainty is worse than knowing what the damages are. Direct damages do not include lost revenue, profit, loss of production, et cetera.

Continuing on, we offer no liability for electric system design common to the industry or electric system operation practices that are common to the industry.

And there is no liability for TO's good faith attempts to comply with the directives of ITPs which I think is an important provision, since many of us who don't enjoy independence to operate independently have basically turned the keys of our system over to somebody else see this is an important provision. Thank you.

MR. BARDEE: Thank you, Mr. Doyle.

Ms. Gullini?

MS. GULLINI: Hi. I'm Maria Gullini. I'm senior counsel at ISO New England. I've provided you with language from our capital funding tariff. It is essentially divided into two pieces. One is the limitation of liability which we have all been talking about today, which basically states that the ISO has no liability for its actions except for its willful breach or willful misconduct and in no situation are there special damages. There is also no liability for our officers and directors.

The second provision is an indemnification provision which you can think of sort of as a belt-and-suspenders type of thing. This provides that other damages caused by our customers or asserted by third parties are -- we are indemnified for those damages by our customers and our officers and directors are also indemnified.

This indemnification is less than any amount of any insurance we are able to collect and again excepts our gross negligence or willful misconduct.

You can also achieve this same effect the way the New York ISO does through a guaranteed pass-through of these damages.

The justifications for these kind of clauses have been articulated very well by Professor Pierce in his recent article. I'm not going to go through them all again, but I do want to emphasize or add a few reasons why we think these

provisions are necessary.

One that no one has mentioned is that it is very, very difficult to attract qualified directors in this environment post-Enron without giving them some guarantees that they will be protected from liability. Additionally, people have talked about the difficulty of securing lending. And, of course, people have mentioned that if nonprofit entities are forced to bear unmanageable liability, the result is inevitably insolvency because of course we do not have risk adjusted returns on equity. We provide our service at cost. Our expenses equal the revenues we bring in. We do not have any kind of cushion to bear these liabilities.

Finally, I do just want to mention that in real life the ISO has had these provisions in place since 1997 without any noticeable impact on our rates and without us ever having employed these provisions. So our real life experience has been that they are workable. Thank you very much.

MR. BARDEE: Thank you, Ms. Gullini.

Mr. McMahon?

MR. McMAHON: Hi, I'm John McMahon, general counsel of Con Edison of New York. I'm here appearing on behalf of the New York transmission owners which include Con Edison and six other major transmission owners in New York

State. I'm here to express our strong support for adoption of a gross negligence and intentional misconduct liability standard in the tariffs.

I first would like to talk about uniformity and the concept of uniformity versus apparent uniformity. And by that I mean what happened initially when the Commission adopted the O tariff, the Commission said look to the states -- you can avail yourself of protections afforded by the States.

That sort of left a void because States such as New York have a public policy that businesses can contract to exclude liability for ordinary negligence, but not gross negligence. That's the State policy. It's in the general obligation law.

What happened with the Commission decision was that the ability to contract was negated because the tariff; the O tariff is the contract and the liability exclusion was not included in there, nor was there a means to include that liability provision.

So -- and that's why -- and in addition to that, by looking to the States for different liability provisions, you would be in effect creating differences in the transmission grid and liability standards and the Commission ought to be promoting uniformity.

I'd also say that uniformity is important -- it's

a way of promoting customer understanding. But if there were different areas of the country that had important reasons for distinguishing, I think clarity also promotes customer understanding, as well as uniformity. And just making differences that are not necessarily clear is a way to achieve the goal of understanding which I think is an important goal.

In terms of the limitations on liability, I echo what was said on the earlier panel. What we are here talking about is supply adequacy, the provision of supply, defects in supply, failure of supply. We are not talking about an individual coming into contact with a transmission line. That is a different matter and it is really not governed by the tariff -- the tariff, the contract between the supplier and the purchaser of that supply. So there ought to be a clear understanding of that. When you get to the issue of why are we here or why is this important, I think it's important to go back to not only the idea of Hornbook concept of the tariff establishing the rates, terms and conditions of the utilities services, but also the idea of financial integrity. That's why it's a public interest question of preserving financial integrity and also reasonable cost.

It's also a Commission objective of being the primary and exclusive regulator of the utilities, and if you

adopt a negligence standard, you're really sort of tilting to the states to say, Well, you ought to trimmed those -- it's reasonable to have trimmed those trees at a different pace in getting to that issue. I mean, gross negligence could happen.

My company unfortunately was found to have been grossly negligent in the 1977 New York City blackout, and it shouldn't have been. It was a jury in my native County of the Bronx found differently in the courts; the courts upheld that. But it's important in terms of preserving the Commission's jurisdiction over good utility practice, and it's important in terms of preserving and maintaining the financial integrity which today, you know, with the tumult in the energy industry is more important than ever that we have standards that provide that reasonable protection.

I'd also like to talk about the idea of remedies. In that we talk about not only the limit on damages but also the idea of bill credits. When service is not provided, there ought to be credits. There's also the concept of -- going back to this concept of privity in the tariff, you have a supplier and a purchaser of that supply. Third parties ought not to have a cause of action for failure of the supply. I'll tell you that in the 1977 blackout the New York courts ruled after there was sort of a jurisprudence built up on damages, the courts ruled that non-customers do

not have a right of action against the utility.

That's an important concept, and I think it should be clear in the tariffs because the courts will look to the contract to see what the intent of the parties was, and we should specify that third parties are not within the ambit of the service benefits. It's the customer and the supplier.

In terms of insurance I think enough has been said on that. It's not a reliable supply. It's not a public utility concept where the regulator says here are the terms, the rates, terms, and conditions of service. It can dry up; it can, in effect, be self-insurance in terms of dollar-one coverage; it can disappear. So I don't think a policy is good for that.

But I would also say that there is business-interruption insurance, and customers can get that. There's a point to be made in that direction in that a customer to whom service continuity is important, it will be important whether that fails, whether there's negligence and no negligence. So for the customer to rely on the negligence or gross negligence for recovery, it would be more rational for that customer to look to the insurer to get insurance to cover the insurance.

I would also like to say that -- and I'm not recommending this -- but I would point out that in the New

York State retail tariffs for Con Edison and Con Edison only in New York State for several decades, there are stipulated amounts that customers can come in to claim, to submit claims to the utility for failure of service. There's complicated rules but the cap is \$10 million. The New York Public Service Commission recently raised that cap from \$1 million to \$10 million. I think New York City and Washington, D.C., are both unique places.

At the same time the Commission increased it, they didn't apply it to anywhere else in the State. So I'm not recommending that, but I think it's information that you might find useful. Thank you.

MR. BARDEE: Just a clarification on what you just said there, Mr. McMahon, \$1 million or \$10 million, whichever it is, was it per claimant?

MR. McMAHON: There's caps per claimant for residential customers, I believe. It's very interesting. We actually did a study of the average value of food in refrigerators in New York City and found that 99 percent of refrigerators don't have more than \$125 in it, but there is a cap of \$350. For small businesses there's a cap of \$7,500 and that's it.

Big businesses are left to the insurance market, et cetera. So there's some equity there. In addition to that, to get \$150 you just have to submit a claim. To get

more than that for residential customers you really have to prove it.

MR. BARDEE: Let's say the \$10 million figure that you mentioned, that's for everybody who might come in for a given outage? That's a total amount for everybody who might have a claim for some incident?

MR. McMAHON: Yes, sir.

MR. BARDEE: Okay.

MR. McMAHON: And there's pro rata reductions if the claims go over the \$10 million for the claimant.

MR. QUINT: Good morning. I'm Arnold Quint. I'm a partner with the law firm of Hunter and Williams. Our firm is counsel to the New York Independent System Operator. I was part of a drafting group of seven ISOs and RTOs that submitted comments in this proceeding. We referred to the comments of the joint comments of the North American RTOs and ISOs. I'm here particularly at the request of the New York ISO, PJM, and the Midwest ISO who are three of the signatories to those comments.

The position that the ISOs take today and that I'll take today and was included in our comments really is based on four driving factors. They've been covered in part by the first panel and in part by this panel, but I think it's helpful just to outline them very briefly.

First the ISOs and the RTOs don't have any

limitations of liability from State law or State tariffs.

So the issue which the Commission keeps asking, you know, to what extent do we look to State tariffs doesn't apply at all in the ISO or RTO context. The New York ISO, for example, though, is an electric corporation for certain New York State purposes. It does not have any State tariffs. We have an open-access tariff here, we have a market-services tariff on file with the Commission. But there is not tariff-based limitation on liability that we could derive from any State tariff.

Second, even if there were State tariffs and there were State-developed limitations of liability in those tariffs -- I mean, Consolidated Edison, for example, has some of those limitations. The limitations are not likely to be applicable to an ISO or an RTO which is providing transmission services. The Commission, of course, has held that is an exclusively Federal service. It's the sole responsibility of this Commission. So even if you had such retail tariffs, which you don't have, they're not likely to be applicable in any event.

Third, insurance for ISOs and RTOs is becoming increasingly expensive. It's very difficult to obtain. The ISO had to go out and renew its coverage. It had insurance from when it started service. When it went out for renewal in the last year, it ended up having to pay twice what it

had paid previously for half of the coverage. So if you were looking at that in a real simplistic sense, it's almost four times the cost of insurance.

As Mr. McMahon has indicated, customers who were taking service are likely to have their own service, their own service-interruptions insurance and other forms of risk management. If you're a large customer, you may have dual feeds, you may have your own on-site generation. Those customers should not have to then also pay for this increasingly expensive insurance that the ISOs have to carry.

Then finally, to a certain degree all of those first three factors apply also to transmission owners in varying and different degrees. There's a fourth factor that applies, I would argue, particularly to the RTOs and ISOs, and that is those entities operate in a non-profit manner. We don't have shareholders. Any cost that we incur is going to be paid by the customers. If you don't allow the pass-through of the costs to the customers, then bankruptcy is the likely outcome.

So we're in a situation only the Commission can take action to address the protections that are needed here. We propose language that has two primary features. First it would limit liability to gross negligence or intentional misconduct. Second, without regard to the standard of care

you adopt, the RTO or ISO should not be liable under any circumstances for special indirect, incidental, consequential or punitive damages. We've all used different terminology, but I think there's a sort of a long list that you could include there.

In our language we've proposed a definition of what direct damages does not include because we think it's probably easier to exclude certain types of potential damages. The language is taken rather shamelessly from that that was proposed to you by the Midwest ISO and by American Transmission Company. As you know, it was approved in part by the Commission in a recent order.

The principal distinctions between what was submitted by the Midwest ISO and what ATICO (phonetic) submitted and what I've submitted are two. One, we would reject liability for ordinary negligence, and so then you don't really need to reach the dollar caps. Those are really the two different points. We're not proposing caps for gross negligence or willful misconduct, but there would be no liability for ordinary negligence.

As I said, a lot of these issues would apply, as well, to the transmission owners. A number of transmission owners have said to me, Are you trying to undercut our arguments? Our answer is no. I want to make sure here today, though, that the Commission understands that, I

think, the ISOs and the RTOs have some separate concerns, separate issues that the Commission has to focus on as it moves forward here.

MR. BARDEE: Thank you, Mr. Quint.

Mr. Stone?

MR. STONE: Good morning. My name is Don Stone, and I've been asked to participate with you here today on behalf of the RTO West Filing Utilities. My perspective on this liability issue comes from being a trial lawyer for over 25 years in the defense of electric utilities. I am one of six attorneys selected by Aegis Insurance Services nationwide to participate in their electric service panel to assist their insureds and their attorneys in the defense what we will refer to as catastrophic injury and damage claims.

For those of you who don't know who Aegis is, Aegis is the largest insurer of investor-owned utilities in the United States.

Now, in speaking on behalf of RTO West Filing Utilities, I would first indicate that we would propose to serve a seven-state region in the west. I think that one thing that you will find that's a little different in our proposal -- and I might add that I have circulated kind of a bullet point list of the specific of RTO West's proposal -- is that from the very beginning, RTO West has attempted to

facilitate a collaborative process that, indeed, has involved not just the transmission owners, but marketers, generators, consumer interests, any entities basically affected by the operation of the RTO to include this interruption of service issue.

It was out of that process that we came up with the specific proposals that are in front of you. Now, I want to add, too, at the outset that what we have proposed does follow the MISO ATC format. It confines itself to electric disturbances, as defined, so as clearly not to come into the realm whether it be a market monitoring issue or whether it be in a personal injury or environmental type of issue, it's clearly confined to electric disturbances.

We in the West have had actual experience with West-wide outages. In 1996 we had two such events, both caused by trees coming in contact with power lines that led to cascading outages affecting large portions of the West. Evaluation of those damages, depending upon whom you would believe, were variously estimated between \$1.3 and \$1.5 billion.

Now, you cannot buy insurance to cover that kind of catastrophic loss at any price. But even if you did, your objective of being able to provide the electric service that you previously provided at a reduced cost diminishes considerably. What we have proposed as part of

our proposal again is confining the scope of liability to direct damages which is expressed again in excluding consequential damages, as well as punitive damages, which we do have in some states in the West. We are including in our proposal a damage cap.

Going back, I think, to the question of Ms. Marlett earlier to the first panel, there was a sense and a feeling that even with the standard of gross negligence and intentional misconduct, that there was need to curb the potential liability loss resulting from one of those events, recognizing that this is a per-incident and not an aggregate, such what can occur today can occur again tomorrow and the day after that. So we could very quickly be dealing with large amounts of money.

I would also indicate that one of the things that I did early on to try to get my arms around the issue to see what it really meant was to look to the Western Systems Coordinating Council's outage reports which effectively trace the impacts of large-scale outages in the Western parts of the United States.

In a typical engineering form they describe in minute detail what could have been done, what should have been done; what perhaps would have prevented this or that from happening. It also capsulizes the scope of the outage, how many parties were affected for how long in terms of

estimates of lost megawatt hours of load.

If you apply what has been bandied about by so-called experts that the value of lost load which are in published studies which were cited as part of Dr. Pierce's papers, you will see 30 to 50 megawatts -- excuse me, \$30 to \$50 per megawatt hour as the cost of that load lost. So if you just take the last 12 major events in the West, on an individual basis it's very easy to come up with hundreds of millions of dollars in potential liability exposure.

Now, why haven't we seen it today? Well, the answer is is because typically we as individual utilities owe a duty only to our own customers. In effect, in this brave new world of creating these new entities which, in turn, are creating duties for other new entities, we are, in fact, creating a situation where there are duties potentially owed to third persons for which there can be responsibility.

Now, I've heard the statement made that, yes, well, there should be that kind of responsibility. Well, and the answer is is to a degree. I would submit to you that one of the questions that you've already addressed this morning is which entity is better served in setting policy. I would submit that even though I've spent my life in a court room, that you are much better versed and particularly in a subject matter such as electricity and the supply of

electricity transmission around the United States to set what is an appropriate policy than is any court.

I would also submit that it may well be that as already alluded to there is certainly a problem with the insurance market. But we're not necessarily going to be able to cast in stone what policy decisions you make today, because those same policy decisions that you may make today, particularly with respect to a cap, may not necessarily apply tomorrow. So it will definitely take monitoring.

If you wanted certainty, you would say there is no liability. That would provide certainty. Now, would it provide responsibility? I think that is part of the policy question. Of course, I guess that I am convinced having lived around the people that keep the lights on for so many years that it's ingrained in their system to be responsible, and they view that as part of their duty.

There are incentives in the system whether it be as part of a regulatory process, a political process, any number of processes that will ensure reliability. There are very comprehensive reliability standards that are being formulated that will necessarily apply. But a cost of compliance with those reliability standards should not be a liability which literally puts these entities on the verge of bankruptcy with the next outage event.

So what we've tried to do is extract compromise,

and in doing so, there are some provisions here that are different. I have to comment that I'm probably the only person here who being from the West believes in a concept of regionalization. In our service area, as you may well appreciate, we have a hydro-power predominance in terms of resources which by its very nature requires coordination and has its own special issues and problems, even from an operational sense.

We have the prevalence of non-jurisdictional public power in our region to the degree of, again, depending on what you count, roughly 77 to 80 percent of the transmission capacity in our service is held by non-jurisdictional public power entities. Frankly, to be successful, our feeling is that they need to participate.

Another desire is to incorporate the Canadian participants. We specifically have engaged and are involved with B.C. Hydro which supports the joint comments that were filed with you.

But I would also suggest to you that we also have a background of cooperative agreements, one of which was the Western Interconnected Systems Agreement which has been in place to effectively limit liability among interconnected electric systems since the early 1970s and has worked extremely well.

So we have this background of cooperation. I

would be the first to tell you that what we've submitted to you is not necessarily perfect. We came here to listen and to learn, as well, and to hear from perspectives of others in different parts of the country.

But I think from the perspective from those in the West, given the fact that we have transmission that's scattered over large distances, in many instances radial transmission lines that don't have the benefit of alternate feeds similar to what is experienced in the East, and because of the fact that we require effective cooperation for the management of hydro resources that we probably have a preference at least to see what you come up with and have the opportunity hopefully of creating something that will be an acceptable business model for operations in the West. Thank you.

MR. BARDEE: Thank you, Mr. Stone.

MR. O'NEILL: Let me pick up on your example. You said that the low-end estimate of the damages of the outage in the West were \$1.3 million.

MR. STONE: Billion.

MR. O'NEILL: Billion, sorry. If we said that there was no liability, there were people who paid who lost \$1.3 billion, and they go home with a big loss and that keeps rates low. My question is since, I think The Washington Post called the incident "due to unruly

vegetation" -- but that could have been, the incident could have been avoided by tree-trimming. Yet, as I understand -- and maybe I'm wrong -- what EEI and ATC's position is that you shouldn't be liable for that. But it keeps the rates low.

MS. DAVID: I would suggest that the parties who suffered that loss could and should have had insurance because they know what their risks are in terms of not having electricity.

MR. O'NEILL: That's insurance against your failure to trim trees?

MS. DAVID: That's insurance against whatever failure there may be not to have electricity at any given time.

MR. O'NEILL: Shouldn't we try to put the risk on the people who are most likely to be able to correct the problems?

MS. DAVID: Well, the risks -- it depends on which risks you're talking about. The people who can correct the problem but who can't foresee what the damage might be are not necessarily the right people to insure against what the damage is. The person who's in the best position to insure against the damage is the customer.

The question for you has to be how high do you want rates to go and how much investment do you want there

to be in the grid? I was very interested in your question, Mr. Bardee, about why shouldn't we let the states develop this because we do energy policy? This is energy policy. If you want to have an electric grid, you better create a system where people will invest in it and where people can reasonably accept the risks of operating it. The states have long recognized the need for limited liability in this circumstance.

MR. O'NEILL: If the customers have to bear the risks, should they be able to trim the trees?

MS. DAVID: Well, I think -- no, the customer should not be able to trim the trees. However, I think that as we saw in that particular instance and as you would see in any instance of a major outage, the utility, the transmission owner, the independent transmission provider, all of the above will have hell to pay in the event of the outage from a public relations perspective, from a financial perspective, from a regulatory perspective. They don't get a free ride.

MR. O'NEILL: So you would argue that if one of these instances happened, the Commission should severely reduce your rate of return?

MS. DAVID: Well, I think the Commission is obviously going to ask a lot of questions in that circumstance.

MR. O'NEILL: Well, what should they do?

MS. DAVID: The parties -- in this particular case, I think, there could very well have been litigation over whether it was gross negligence, whether it was willful misconduct. But I don't think that it's necessarily --

MS. DAVID: The question is whether it is appropriate to cause all of the customers and all providers to fund all of the losses.

MR. O'NEILL: But could you be more specific as to what "hell to pay" means?

MS. DAVID: Well, I think that you would certainly have Commission inquiries as to whether good utility practices were observed. You would have inquiries by the regional reliability counsel. You would have certainly State regulatory bodies asking the same questions. I know that in the City of Chicago we would have the mayor highly incensed.

So I think from a practical perspective, even if there are not money-damage remedies in place, there is another wide array of remedies available to both the Commission and to other regulatory bodies.

MR. BARDEE: Ms. David, I had a question on something you had mentioned in your statement referring to declaratory orders and injunctive relief. I'm just trying to figure out how that works in the context of the issues

that we're discussing today of concerns such as Mr. O'Neill just brought up. What kind of actions are you envisioning that would be and how effective would they be?

MS. DAVID: Well, for instance, your tree-trimming example. If you have got a transmission owner who has decided we don't do that tree trimming stuff anymore, let's skip it for the next 5 years, it saves us a lot of money. The local distribution company may have a disagreement with that or a customer who is experiencing frequent transmission outages may have a problem with that and may actually bring an injunctive relief or declaratory action to determine that that is a practice that cannot be continued.

MR. O'NEILL: Are you going to announce that you're not tree-trimming? I mean how are people going to figure out that you're not trimming trees?

MS. DAVID: Well, that's a good question and I don't really have a answer for that one. But I think that what you have to keep in mind is that you're going to have over the next several years as the industry restructures you are going to have more transmission-only companies, more load-serving entity companies and independent transmission providers. Those companies will interact and probably rub against each other quite frequently. And I think that some of those policy concerns and some of those internal company

actions will get aired in that context and you'll see, in fact, the customer, the big customer, the load-serving entity is the one who is going to exercise the greatest amount of discipline against the independent transmission provider.

MR. BARDEE: But to use that example again, suppose you stopped tree trimming or did it by cutting the costs way, way down to the point where some judge might find that it was grossly negligent. The judge then poses an order that says hire more tree trimmers and keep it under my supervision for the next year or two? Is that the kind of thing you are describing?

MS. DAVID: Well, no. If it's -- I don't think that you would need to necessarily have that as a gross negligence standard. This is a -- for instance, any company could bring an action saying they are not trimming the trees often enough, we're having too many outages, I want a mandatory injunction to compel them to trim the trees more often.

MR. DOYLE: The issue of -- let's take this tree-trimming issue, you can take these vignettes and can you turn them into very, very interesting scenarios, but let's take a real life example. Several years ago -- I'm not a tree trimmer --

MR. COLEMAN: By the way, the tree trimming was a

real-life example, I believe.

MR. DOYLE: Yes, I understand. As is this one.

In Wisconsin, we did at Wisconsin Power and Light we did our cycle tree trimming. We were on the cycle. We ended up getting a summer of very, very, very heavy rainfall and vegetation just took off on us, created all kinds of problems in an area and we had done what was appropriate. And my question to you would be: Was that negligence? Gross negligence? Should we have known? Should we not have known?

Were we following I think what underlies all of what we're proposing to you, which is standard good sound utility operating practices? And I think that is the standard.

The other thing I find it interesting when we get into discussions and I don't mean this to be disparaging but we always look for the carrot and the stick. And I think the system works, as a utility executive having operated and banged around in this industry for 25 years, I can tell you the last thing I want are the public relations problems, the political problems, the board problems that come along with not operating within the guidelines of good utility practices. That is standard. I just don't want to be in the paper.

The other issue that comes into play that I think

was missed this morning is this payoff of negligence versus gross negligence. If somebody thinks they have a claim, are they going to come after us for gross negligence or are they going to come after us for negligence? I think they're going to start where the pocket is the deepest, and what I think we've got here is a policy where we are going to have to defend ourselves against that standard and make sure that we are operating within the boundaries of good operating utility practices so we can stay out of that area.

And I think those are the tensions that are already built into the system so we can avoid this sort of carrot and stick type thing.

You know, our proposal to have a cap in there was put forward basically as sort of a political compromise. It's very simple to think that the utilities should have some skin in the game. It's very difficult to understand all the economic arguments as to why it makes sense for somebody who has all the information, understands their risks, knows what the standard of service that is being offered under the tariff is, understands normally how often their service is going to go out, to take appropriate actions. That's a difficult argument to explain. It's very easy to land in situation where the utility ought to have some skin in this game.

Our view is that no liability on directs for

negligence is the right place to be. If there's a political compromise that's necessary, what we offered in our testimony was built off of the liability of common carriers and innkeepers and so on where they have a minor amount of liability for loss cause based on their service but not so much that it is going to bankrupt them. And it provides an appropriate signal to the customer -- and I'll use the example, if I'm going to send a \$25,000 diamond ring to my girlfriend and put a 34-cent stamp on it and not insure it, I'm subject to some loss. I can't put that externality on somebody else. Nobody knows there is a diamond in there. We have to get to a standard where there is an appropriate balance in that area.

MR. COLEMAN: Actually, Mr. Doyle stole some of my comments that I was getting ready to make. I would just reiterate Duke has proposed a balanced approach in which the ITCs and ITPs would have -- bear some of the risk, so we would not shift it all to the customer. We do think that they need to bear some of the responsibility to make sure that the right incentives are there and that it drives the right behavior.

But Mr. O'Neill brought up the question about whether -- shouldn't the party that causes the harm bear the risk? And I guess what I would say to that is that at some point -- I see this as an allocation of responsibility or

allocation of risk and the ability to insure it. And at some point you're not going to be able to drive the right behavior when the damages get so high, it's not going to matter.

MR. O'NEILL: I don't have any problems with putting limitations as long as the limitations aren't zero. While we have you here, I noticed that your tariff includes acts of God, public enemies, war, insurrection, riot, fire, storm, flood, explosion, and labor disturbance. What's a labor disturbance?

MR. COLEMAN: A labor disturbance would be something that is not a strike, but laying down in the road and blocking the ability to perform. You are picketing outside and throwing rocks.

MR. O'NEILL: If they are college students and not

--

MR. COLEMAN: I would say these have to be employees of the actual entity.

MS. GULLINI: I actually have a question for Mr. O'Neill, which is --

MR. O'NEILL: Wait, I'm on this side of the table.

MS. GULLINI: That's right. I can't speak to Tos, but if you have an ISO, a nonprofit entity that bears liability for its negligence, let's say we -- this doesn't

happen because we're not responsible for trimming trees, but say we are at fault for not trimming a tree. Who pays for that judgment?

MR. O'NEILL: The way you would ideally like to set these issues up is to get the incentives right. And if, in fact, the ISO's negligence, gross negligence, just bad management caused a problem, you want them to bear some financial pain. I'm not saying every last nickel.

And so the idea would be -- and I realize that we're just getting started here and the insurance companies are very nervous, but for even nonprofits -- and I just don't understand the difference between profits and nonprofits because if the insurance was available, you would buy insurance against it. And one of the things that insurance companies do is they actually monitor your behavior and in some sense we have market monitors for monitoring for market power behavior. Insurance companies actually monitor for good utility practice, which actually in some sense keeps us off the hook to a certain extent.

And so the idea of, A, getting the incentives right, and B, getting insurance companies who have experience in helping people set up programs to avoid the problems seems to me to be a very good way to go about doing this business. I realize we may have trouble getting started because we don't have an insurance industry that's

got familiarity with the business. But as I said this morning, we have lots of databases. And as Mr. Stone said, we have lots of information on the history of these outages. So we should be able to get a handle on it.

MS. GULLINI: If I could, I'd like to make a couple of comments in response to that. One is costs of insurance are going to be paid by load. Just the same as damages would be paid by load if they were passed through. And this is something Ms. David had alluded to earlier which is that if I'm a residential customer and I lose my \$125 worth of groceries, it's --

MR. O'NEILL: If you are insured, the damages are not paid.

MS. GULLINI: If we're insured. But our insurance -- the costs of the policy are going to be paid by load. And I'm assuming they are going to be very high. I know from our own insurance they are going to be high.

So my point is that because of the pass-through nature of the type of entity that we are, load is going to pay no matter what, whether it is for the costs of the insurance or an uninsurable judgment. And in that event, it's going to be disproportionate and that is my point and that I think is the point Ms. David was making is that load is in the best position to bear its direct costs. Otherwise, the residential customer who just loses groceries

is going to pay a much higher proportion based on the industrial customer who loses thousands and thousands of dollars.

MR. O'NEILL: So you want me to insure your activities?

MS. GULLINI: I think that load has to pay. It is a social cost of the type of business that we are in. As a nonprofit we do not collect any revenues in excess of our costs. Somebody has to bear, and I think the position we're taking here is that load is in the best position to pay.

MR. O'NEILL: Could we make you profitable?

MS. GULLINI: It's --

MR. O'NEILL: Is the answer to make you a for-profit entity?

MS. GULLINI: And then I would say that the risks are inherently unmanageable and our costs would be astronomical.

MR. O'NEILL: So the issue is really not nonprofit.

MS. GULLINI: I don't know that I agree. The risks of market monitoring, of plan of loss of load, all of those things are very, very difficult to insure and I'm afraid that a risk-based return on equity would be very, very high. Also I'm not sure we want to be in the business of making profits. I think -- this is probably a

controversial point, but I think that that would impede to some degree our independence. I think that that is the position we feel in New England anyway.

MR. O'NEILL: Do you have performance incentives?

MS. GULLINI: I still don't know that that doesn't go back to the essential point which is that creating rates that would cover these kinds of risks are going to be very high and very difficult to quantify.

MR. O'NEILL: If we limit them, if we limit the liability? Very high liabilities, I agree with you. But if you limit the liabilities?

MS. GULLINI: Our liabilities are limited now. We currently are exposed for our gross negligence and willful misconduct to unlimited liability to those things, so we're living with those things today.

MR. O'NEILL: The difference is zero and some number; right? That's what we're talking about; right?

MS. GULLINI: Yeah, I mean we feel comfortable with the balance we struck in our tariff.

MS. DAVID: I would like to address the notion of insurance as -- you keep talking about incentives to act appropriately. If you are paying claims through insurance, then you're not suffering the consequences of your actions. Your insurance company is suffering the consequences of your actions. Your rates will go up, somebody will suffer

eventually, and eventually your insurance will be canceled.

MR. O'NEILL: That happens with all insurance, doesn't it?

MS. DAVID: Yes, it does.

MR. O'NEILL: Is that an indictment of insurance?

MS. DAVID: No, what I think you have to recognize is that ISOs, ITPs, RTOs are much more like taxing bodies than they are like businesses and it really isn't the not-for-profit nature of it, it is that we have marshaled the assets under the control of a body that is going to make decisions in a very high-risk business where the losses could be huge. So this is the argument in fact for nuclear insurance.

But I think you have to recognize that what happens for this essential commodity -- we all have to have electricity -- is that the prices simply go up. The ISO raises its rates to reflect the increased cost of insurance or the increased cost of paying claims. Or if you're talking about a for-profit entity it simply raises its prices or goes out of business. We can't afford to have it go out of business, so it will simply raise its prices.

These are extremely difficult risks to manage. We don't believe a cap works because the risk of loss is too large in a single instance. A \$500,000 cap could be meaningless in a major outage. Mr. Stone talked about an

outage where the claims could have been \$1.3 billion. So that means that everybody who suffered a loss may have gotten a nickel. It's just not meaningful and it doesn't act as a deterrent.

I think that Mr. Doyle's point that the industry already acts -- it works, is the right one. The possibility of paying a \$500,000 damage claim or a \$1 million damage claim isn't going to get the result that you want. What you are going to do is to create a race to the courthouse to reduce claims to judgment, because it is going to be first-come/first-served every time there is an outage and you are going to have claimants be subject to the length of the docket in their courthouse and forum shopping and trying to get the fastest judgment for the biggest amount possible, going to high tort claim States, looking for big jury damages to get the biggest percentage of that \$500,000 amount.

I think the cap notion simply doesn't work and it encouraged litigation instead of discouraging it -- instead of encouraging appropriate behavior.

MR. BARDEE: If I could change the subject just for a minor point here, Mr. McMahon, in your statement you had talked about how only the customers would be allowed to recover for incidents and that third parties, nonparty to the tariff, would not have a claim against you for service

under the tariff.

I want to make sure I understood that and then check with the others to make sure that is the same position they are advocating or understanding they have.

MR. McMAHON: The tariff is a contract between the supplier and the customer and in that 1977 incident that I referred to, the New York courts ruled that, for example, New York City, which was an indirect consumer was not -- didn't have a cause of action, was not a plaintiff that could recover in that case.

MR. BARDEE: Would the rest of you agree with the position that he has advocated here? Or described, I should say, in that under the tariff when we say liability exists only for service under the tariff, that that means that the customer only has a right to recover?

MR. STONE: That has been the traditional response of the courts. My concern is that with the creation of these new duties and responsibilities, that you may well see an evolution under the common law of individual States to expand that liability to third parties. Ultimate consumers, if you will. And I think the desire here is to clearly cut that off.

And I feel that, you know, perhaps my earlier statement about this database that we have to rely upon, it's very inexact science. And quite candidly if you looked

to those numbers if you were in the insurance industry, no one would enter that field unless you were literally achieving very high premiums which are going to translate into very high costs for consumers. Just trying again to quantify that, we figured that looking to the cost-benefit analysis that I have seen for RTO West, it's clearly outnumbered, if you will, by a single event, and we can't let that happen.

And when you talk about a nonprofit, I think one of the things that is missed about a nonprofit entity is that other than insurance, and potentially its ability to cover costs through rates, it has no assets. So when you are dealing with filing utilities who are asked on a voluntary basis to join such an organization, there is a reluctance to do so when they are turning the control of their assets over essentially to the RTO and if in turn that liability could then flow.

Now we're also dealing in the Northwest specifically with an agent of the Federal Government. The pine tree that I mentioned to you involved a Bonneville Power Administration line who owns their right-of-way, and probably has some of the best tree trimming that exists in the Northwest. No one can predict which tree is going to be the next one to fall and these events will happen. And the point is that you can't all live on the edge of bankruptcy

and have any kind of an acceptable business model that is going to attract capital and will be viable on a daily basis.

MR. O'NEILL: My understanding was that it was not a falling tree but that the line sagged into a tree that hadn't been topped off.

MR. STONE: Well that was the incident in Wyoming. There were two events. Okay? Now it can happen in the mechanism that you described and that can be an issue of overloading a line. Remember that the RTO will be controlling the line. The capacities of that line may well have limitations and if you overload a line for a long enough period of time, you can have increased sag and some of the clearances that some of those standards have provided to you effectively don't exist anymore.

So you can understand why as an owner of those facilities and you're turning over -- essentially you're turning over your car to be driven by somebody else and you want to make sure that if there is an accident -- and I would submit that accidents do happen -- that you're not going to be left and held with responsibility and particularly over acts over which you really have no control.

MR. O'NEILL: I have two children under 25. I understand turning over your car.

MR. STONE: And you know a lot about insurance rates too.

MR. O'NEILL: Yeah, I wish I was indemnified. I'd like somebody to limit my liability. My rates would go down.

MR. BARDEE: I'd like to use some of our remaining time to figure out where you all agree or disagree on some of the main topics we have been talking about today and try to figure out where the consensus is and ask some detailed questions about each as we go through it.

Let's start with one of the foremost and I think you all probably support this but I want to make sure. I think you're probably all -- in terms of limiting damages to direct damages, do you all support that kind of outcome that the Commission, if we are going to adopt liability limits in the S&D NOPR, we should limit damages to direct damages?

MR. COLEMAN: Duke Energy supports limiting them to direct damages, yes.

MS. DAVID: Absolutely. I should add also, I neglected to add in my opening that we circulated proposed language for the tariff.

MR. DOYLE: We support it.

MS. GULLINI: We do, too.

MR. McMAHON: I think that is right. I would also reiterate the suggestion about bill credits. If you

don't get service, you don't pay for it. And that is again a signal that aligns the interests as are sought to be aligned.

MR. QUINT: We agree that that there should be a limit to direct damages. Stone also agree that there should be a limit to direct damages with one caveat in that, again as part of our collaborative processes and due to? Input from some of the merchant functions and the Bonneville Power Administration there is A desire to have some sort of compensation for so-called wrongful dispatch orders.

MR. BARDEE: And this is sort of a follow-on to that. For those of who you are here on behalf of transmission owners or anyone who is regulated under State tariff right now, are your damages under those tariffs limited similarly to direct damages?

MR. COLEMAN: I'd say I am not in a position to answer that question today.

MS. DAVID: Our damages are a matter of State law and we have a State law provision that would not limit our damages necessarily if there is a major outage.

MR. BARDEE: So it might be more than direct damages?

MS. DAVID: Yes, it depends. But as a general rule, I think our damages are limited to direct damage.

MR. DOYLE: I think earlier you talked to

Commissioner Garvin about what the provisions were in Wisconsin. They were slightly different but we are excluded from all damages but are held to a good operating utility practice standard. So what ATC has put on the table in terms of having a cap would be more onerous than the protections that existed before the assets were transferred to us.

MS. GULLINI: We're a multi-State ISO. We have no State protection.

MR. McMAHON: I don't know the answer to the question.

MR. QUINT: The New York ISO has -- well, I think the question is really going to individual utilities, so I will pass.

MR. STONE: Well, I would just comment that first of all, 80 percent of the transmission in the Northwest is provided by a Federal entity which has the benefit of sovereign immunity and the application of the Federal tort claims act. Beyond that, State tariffs are frankly all across the board. Even in the context of the same State they do not necessarily provide the same measure of protection for individual utilities operating in that State, which is one of the reasons that we believe at least within the footprint of RTO West that we need probably a uniform rate and one that is acceptable from a standpoint of

all who were voluntarily participating. And particularly when you have an entity with 80 percent of the transmission that effectively may have no liability because of sovereign immunity and yet you want them involved.

MR. O'NEILL: Mr. Stone, just to clarify something you said earlier, you said something about firms without assets. Now, BPA has a lot of assets.

MR. STONE: Yes, but BPA is not RTO West. RTO West is a nonprofit corporation. But --

MR. O'NEILL: But BPA is a nonprofit with a lot of assets. What's the issue there? You can't go after the assets, I guess?

MR. McMAHON: You have it. You got it. The issue with the tree that you suggest.

MR. O'NEILL: But it's not whether they have the assets or not.

MR. STONE: But can you bring a lawsuit? Do they share proportionately in the potential liability? And the answer is no. And they are not willing to give that up understandably.

MR. QUINT: But also remember with the ISOs and the RTOs the assets they have are the software and the computers. They don't have power plants. They don't have transmission lines. You take the assets in any kind of a judgment kind of action and they simply have to go out of

business. They can't run their shop.

MR. STONE: And you also have to understand that with cascading outages events which I think is one of the things we are really trying to protect against, that is the true catastrophic loss that cannot be protected against. You can have the initiating event, but then what is done in response to that event can complicate the picture. And in terms of assessing whether it be liability, whether premised in negligence or gross negligence, you are going to look to what occurs along that line of effectively split second decisions and in fact the wrong button can be pushed. And while it may be the Bonneville line that experiences the first difficulty and they have no liability for that event, what happens in the aftermath could be problematic for all concerned.

MR. BARDEE: The next question I wanted to just confer with you on, many of you have supported exclusion for ordinary negligence or a cap limiting damages under ordinary negligence. And I'm not clear from my notes if you haven't yet said on the record what your position is either supporting a total exclusion on ordinary negligence or a cap on it, and if so what the method is for determining the cap. If you would like to add that right now, I would appreciate that.

And certainly Mr. Doyle, we're aware of your

position and I think at least one or two of the others have endorsed the same position on the cap.

One other point -- there are a couple of others but --

MR. McMAHON: If I could just talk on the cap.

MR. BARDEE: Sure.

MR. McMAHON: I think that the difficulty is designing and calculating a cap. And a cap, one of the benefits of a cap would be the idea of this whole issue of, you know, a negligence standard is just, you know, that it's one way of saying it is that it assigns cost with the person who could have prevented it, but it is in effect -- what the problem is that it turns into a prudence investigation by nonexperts in the courts. And it's often the case what happens is who cuts down on tree trimming is the entity that is having financial problems. So a cap is important for any standard.

MR. BARDEE: Ms. David?

MS. DAVID: I would state clearly that our position is that we don't believe there should be any liability based on negligence, only on gross negligence or willful misconduct. And I think we have stated the many reasons we don't think a cap is appropriate or workable.

MS. GULLINI: We agree. And I would assert that a cap becomes a floor. I don't think caps are effective.

MR. BARDEE: The next point I wanted to check with you all on, at least one or two of the speakers on this panel and earlier this morning said that the claims should only be for service under the tariff and not for harm to property or physical damage, that kind of -- personal damage, that kind of claim. Do you all agree that position that it is only for the economic types of claims under the tariff?

MR. COLEMAN: Duke Energy supports that provision that it should only be for services provided under the S&D tariff, yes.

MS. DAVID: It is only for claims based on service provided under the tariff.

MR. DOYLE: I think I said that earlier. That's where we are at.

MS. GULLINI: Our tariffs currently state that it is only related to our acts under the tariff.

MR. McMAHON: Are you talking about in terms of personal injury? Or --

MR. BARDEE: Yes, at least one of the speakers earlier said that it would only be for service provided under the tariff, but would not apply to claims of personal injury for example. And I wanted to see if all the panelists were supportive of that position.

MR. McMAHON: The personal injury becomes more

remote from the failure of supply. Failure of supply is an economic transaction and a personal injury seems more remote than that, beyond that.

MS. GULLINI: I just wanted to clarify we're limited to direct damages of any nature. It doesn't matter whether they are physical property damage or economic.

MR. BARDEE: Okay. Mr. Quint?

MR. QUINT: Yeah, the language we submitted refers to service under the tariff.

MR. STONE: RTO West proposes that we're dealing here -- we are dealing here with electric disturbances and that is the scope of the liability protection. And in terms of what damages of course are recoverable, I can submit one thing that with outage events has been an area of increasing liability is for instance with stop lights. Now, most courts have construed no duty absent a separate contract to maintain the stop light.

But again you can look to other areas where, for instance, security all the sudden no longer exists because of interruptions of electric service. But I think that those who are knowledgeable about the issue would submit that for the most part many of these can be taken care of by alternate means by the customer. And again going back to the philosophy of all of this, it's we're not going to basically charge everyone the expense of the customer who

provides the least measure of protection. And that's not fair.

MR. BARDEE: Another issue raised earlier today was the argument that the limitations on liability should not apply just to the RTO or the ITP but should apply to also to for example generation owners that are following the direction given to them by the RTO or ITP. Or an ITC operating under an RTO if it is following the direction of an RTO and hasn't engaged in its own gross negligence in following those instructions, that it should similarly be exempt under the same standard because it's been following direction. Do you all support that position for ITCs, generation owners or others who may be following directions of an RTO, for example?

MR. COLEMAN: Duke Energy supports that. We made that statement in our opening comments. I would refer to I think it was Mr. Cornelli said on the first panel that I thought it was a good quote that the generators would be in the chain of causal connection in that they will be providing services, bar support, ancillary services and other things that could possibly fall under the S&D tariff and therefore if there are certain services they are providing at the direction of the ITP, that the person seeking compensation would look to them if they -- they would look to the next deep pocket if they could not recover

from the ITP or the TO.

MR. O'NEILL: Excuse me, in that provision, you would certainly be responsible if you saw a problem of informing the RT or ISO that you saw a potential problem due to its direction?

MR. COLEMAN: Correct, it is not absolving the generator from all responsibility.

MR. O'NEILL: But the first thing would be that you would notify them that there is some problem that exists in their orders, not just sort of sit there and mindlessly follow them.

MR. COLEMAN: Yes that, is correct.

MS. DAVID: And we also support extension of the limitations of liability to the transmission owner, ITCs, generation owners when they are acting under the direction of the ITP, et cetera.

I would also like to clarify my answer to your question of whether this should apply to personal injury or other sorts of claims. I think the limitation of liability has to apply to everything that flows from provision of service pursuant to the tariff, and that may include property damage or personal injury.

MR. BARDEE: Okay.

MR. DOYLE: On its face we would not have a problem with a provision like that. But I think that it's

important to point out that you know we've got two generation sectors. We have one generation sector that is still connected with the vertically integrated utility that is regulated by the State which would arguably have the State related liability provisions that cover it today. The other one is the IPP. And Professor Pierce made this point, but I'm not sure he made it clearly enough. The IPPs in many respects have an ability to contract away a lot of risk. And in that respect, they're very different from a transmission provider or a transmission owner in that we have a one-size-fits-all model for the same price.

So we have a single standard against which you measure the risks and perils that individual customers face being subject to that one-size-fits-all model.

I would just -- the point I'm making is I would be careful to extend too much of what we are doing for the transmission organizations to the IPPs without looking at in more detail at some of the differences which are pretty big, I think. So I just don't think we ought to just apply it blanket. But the initial question we have no problem with what you propose.

MS. GULLINI: Us, too.

MR. McMAHON: In terms of directing a generator to take certain steps in the abstract, it doesn't sound unreasonable. Generators are a different animal in the

sense that they are, you know, are competitive entities. There is another question down in the Commission's questions about standards in interconnection agreements or what not. I assume those would be negotiated and any differences brought to the Commission and reasonable results reached.

MR. BARDEE: I do want to come back to that point. That was one of the remaining questions I have, but let's finish this one first.

MR. QUINT: I tend to agree with Dan Doyle. I think there are probably three separate reasons why the Commission shouldn't immediately include generators in the scope of what you are trying to do today. Number one, I just don't think it has been part of the scope of the proceeding so there are probably more issues you need to look at to make that kind of a decision.

But, two, we're talking about a tariff on file at the Commission and most of the generators are operating under market based tariffs and you've got a 1 or 2-page tariff that doesn't get into this level of detail. So I'll not sure whether it makes sense for them to get into this kind of level of detail.

And, three, most of the arrangements that I am aware of have a provision that says the generator doesn't need to follow the order of an ISO or RTO if it believes

that the order or directive would damage property or injure individuals or kill people, I guess is the best way to put it. So the generator has some ability to simply say, no, I'm not going to follow that order because I think there is a real serious problem here.

And so that's another factor I think that you need to look at before you jump to any conclusions about what to do with generators.

MR. STONE: Again, probably because of the hydro dominance in the Northwest, I think there is a very real perception that generation and, for that matter, the legal protections afforded generators should exist in the same world as would exist for the transmission owner and the transmission operator. It is a significant issue for Bonneville Power Administration. It's a significant issue I think because in part it parlays some of the rules of physics into the world of legal liabilities.

What we had proposed initially with a stage 1 timing in RTO West to cover a good deal of this in the form of agreements which did adopt a central tariff provision but those were basically stricken by the Commission. And so we're left with the tariff as the only real available mechanism to provide the desired limitations of liability needed by generators. And those participating at least in our collaborative process, including the independent power

producers, were of the same view.

MR. O'NEILL: Could you say a little bit more about the differences between hydro and thermal with respect to this?

MR. STONE: I'm not an engineer. I have to listen to the engineers try to explain it. But I can tell you in the hydro generation field first of all there is a lot of coordination that has to take place, both upstream and downstream, in managing the hydro flow necessary for operation of the resource.

Another issue exists with the nature and type of turbines utilized and the degree of coordination. I'm told for instance that some of the turbines cannot be protected to the degree for instance which a gas-turbine-generation facility could be protected by its own protective mechanism relaying.

So I can't answer the question altogether. But I can tell you that those dealing with hydro resources and particularly at Bonneville feel that it is a big issue and one that cannot be ignored.

MR. BARDEE: I did want to come back to the point Mr. McMahon was raising about bilateral agreements underneath the tariff, interconnection agreements or any other kinds of agreements that might be filed under the tariff. Do you all think that the Commission should allow

bilateral arrangements that are different than whatever policy we adopt for the tariff itself?

For example, should a transmission customer be able to assume agreement risks or more liabilities of its own instead of whatever we decide to impose upon the transmission provider under the tariff?

MR. COLEMAN: Obviously, it is a question I'm having to think of on my feet. My initial reaction is no, in that we would propose uniformity across the board. I think for the earlier reasons discussed I think it would skew investment decisions and skew reliability. We support uniform limitations across the board and so we do not support regional variation. I think if you allow that you are getting into the regional variation problem so I do not think we would support that.

MS. DAVID: We would agree with what Mr. Coleman said. The exception that I think we do need to keep in mind, however, is that I think we should permit transmission owners, independent transmission providers and ITCs to govern their relationship and allocate the liabilities among themselves in a bilateral fashion.

But I think in terms of the generator interconnection agreements, I don't think we should allow that to simply be open season for generators to insist that transmission owners or transmission providers take a greater

share of liability.

MR. DOYLE: On the transmission side, I can't think of a reason why we would support bilateral contracting with transmission customers. You know, I do think that there is a space in one of the questions that you sent out with the agenda which hit on the issue of should we continue to rely on negotiation? I think that's one of the tools that's available in the generation sector, and as long as it's done in a way that doesn't hold transmission companies hostage to the whims of the generators, I think we need to set a standard in the tariff and if you can't agree, it's the standard in the tariff. If you want to bilaterally agree differently on a particular provision, that would be fine. But that would be our position.

MR. BARDEE: If we allow bilateral deviations like that, and assuming for the moment -- although it is certainly not decided yet -- that the Commission asserts that it has jurisdiction over unbundled retail transmission, would you assert that even for retail customers negotiating in those settings that we ought to allow deviations or we should just have a standard?

MR. DOYLE: I'm not sure I understand the question. Can you try it one more time?

MR. BARDEE: Let me put it this way: I'm wondering whether there is a reason to differentiate. Say,

a big generator comes in and is putting up a thousand megawatt facility. I could see less concern about parties negotiating what they thought best in that setting than the setting of a major transmission provider negotiating or imposing, if that's how it actually plays out, a standard that differs from the tariff standard on a bunch of small customers.

MR. DOYLE: Well, if I interpret you correctly, you're asking do I support the transmission provider imposing non-tariff provisions on retail customers? I think you would tell me I couldn't do that.

MR. BARDEE: Probably.

MR. DOYLE: I think that's the answer. So I guess the point is I don't see a scenario where that would work where we would not be talking to one another.

MS. GULLINI: I think we would prefer to see standardization and spend more times doing our jobs and less time negotiating.

MR. O'NEILL: Do you need special hydro provisions?

MS. GULLINI: In New England? No, we don't have much hydro in New England.

MR. McMAHON: This gets back to negotiation is okay with me, but I would never give up -- it is so important the protection that you need in terms of an

interruption of service or a failure of interconnection. I would never give it up and trust my fate to a civil jury. I mean it would be -- so, sure, you can free me to negotiate in that way. But it could be -- that provision would be intrinsic, so I wouldn't give it up. But if you want to free me to not give it up, I could --

MR. QUINT: I'm not sure how you avoid discrimination problems if you have individually negotiated provisions. I thought your question was going to go to one that was in the other questions and that was are there contracts between ISOs and Tos for example? And the answer is yes, and there may have to be different provisions in those type was contracts, but that is not a transmission service arrangement. Transmission service it seems to me has to be uniform.

MR. BARDEE: I assume -- and if anyone disagrees, please say so -- that we would continue to be flexible in the arrangements between a TO and an RTO, for example. And that is separate from the question that I have been asking. I mean I think that is what we said in an order involving RTO West, if I am right. That we were not as concerned about how they set up the arrangements between themselves. It was the concern about the customers or the third parties that we were protecting.

MR. QUINT: I'm glad to hear you say that.

MR. O'NEILL: Arnold, can I ask you the question that we asked New England? Do you need special hydro provisions?

MR. QUINT: We have some special provisions in how we dispatch them, because they are energy-limited resources in our concept. And so we treat them as energy-limited resources. But I think that is really the only reason to treat them differently. It is really more on the energy side of the market on the way we dispatch them.

MR. STONE: I would just comment that RTO West has is probably been a proponent of the ability to reach an agreement. Again probably because of its history of the cooperation and the background for the western interconnected system agreement. But also for the desire to incorporate B.C. Hydro in the process as well as the Province of Alberta.

It's also premised on a desire to work out an arrangement that would hopefully be attractive to nonjurisdictional public power interests who are vital to an RTO operation in our part of the country. Now it has its special problems and we have already addressed several of them, but one of them is for instance is indemnification. There may be a legitimate issue as to these particularly nonjurisdictional public power interests in their inability to indemnify.

So we have some built in limitations and so what we are overall looking for in the end I think is probably a default to what would hopefully be favorable limitations on liability established by FERC at this level in the event the parties could not reach agreement.

MR. BARDEE: I'd like to thank you all. It's been interesting and we have our work cut out for us. Thank you for coming.

(Whereupon, at 1:03 p.m., the meeting ended.)